

# DOCKET SECTION

BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, D.C. 20268-0001

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POSTAL RATE COMMISSION  
OFFICE OF THE SECRETARY

Docket No. R97-1

POSTAL RATE AND FEE CHANGES, 1997 )

## INITIAL BRIEF

OF

VAL-PAK DIRECT MARKETING SYSTEMS, INC.,  
VAL-PAK DEALERS' ASSOCIATION, INC., AND  
CAROL WRIGHT PROMOTIONS, INC.

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Val-Pak Dealers' Association, Inc., and  
Carol Wright Promotions, Inc.

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## TABLE OF CONTENTS

	<i>Page</i>
TABLE OF AUTHORITIES . . . . .	vi
STATEMENT OF THE CASE	
COURSE OF PROCEEDINGS . . . . .	1
The Postal Service's Request . . . . .	2
Discovery of the Postal Service's Case-in-Chief . . . . .	3
Val-Pak/Carol Wright Direct Testimony . . . . .	4
Direct Testimony of Other Intervenors . . . . .	5
Val-Pak/Carol Wright Discovery of Other Intervenors . . . . .	6
Rebuttal Testimony . . . . .	7
SUMMARY OF ARGUMENT	
ARGUMENT . . . . .	11
I.    THE POSTAL SERVICE'S REQUEST FOR STANDARD A ECR RATES IS BASED UPON A CREDITABLE, BUT LIMITED, COSTING AND RATE DESIGN . . . . .	11
II.   WITNESS HALDI PROVIDES THE COMMISSION WITH AN OPPORTUNITY TO RECOMMEND BOTTOM-UP COST-BASED RATES FOR STANDARD A ECR MAIL . . . . .	15
III.  RATE DESIGN WITHIN THE STANDARD A ECR SUBCLASS SHOULD CONSIDER THE APPLICATION OF THE 39 U.S.C. SECTION 3622(b) CRITERIA TO PRODUCTS WITHIN THE SUBCLASS . . . . .	23

	<i>Page</i>
A. The Commission and the Postal Service Have Applied the Section 3622(b) Criteria to Products Within Subclasses, When Appropriate . . . . .	23
B. Cost Coverages for Products Within a Subclass Should Be Based on the Statutory Criteria, Not <i>Ad Hoc</i> Rationalizations . . . . .	27
C. The Cost Coverage Requested by the Postal Service for Standard A ECR Letters Has Little Relationship with the Actual Implicit Cost Coverage Paid by Mailers of Discrete Products . . . . .	29
IV. IN HIS REBUTTAL TESTIMONY, MOAA WITNESS PRESCOTT PROVIDED NEITHER MEANINGFUL NOR SUBSTANTIVE REFUTATION OF DR. HALDI'S DEVELOPMENT OF BOTTOM-UP COSTS FOR ECR LETTERS AND NONLETTERS AND DR. HALDI'S SUBSEQUENT PROPOSED RATES . . . . .	32
A. Witness Prescott Inaccurately Asserts That Dr. Haldi Relies on Overall Average Transportation and "Other" Costs for Letters and Flats Combined . . . . .	32
B. Witness Prescott's Assertion of Mathematical Errors is Faulty	
1. Witness Prescott Admits the Correction of Alleged Mathematical Errors by Dr. Haldi Would Have Minimal Impact on the Rates He Proposed . . . . .	35
2. Witness Prescott Make Much Ado about Nothing in His Alleged Error of a 0.005 Cents Per-Pound Correction . . . . .	35
3. Witness Prescott Finds an Error of Transposition in Table A-15 Which He Claims Is a Mathematical Error . . . . .	37
4. Witness Prescott Considers Dr. Haldi's Constant Margin of 8.119 Cents Per Piece and Constant Mark-up Ratio of 2.4405 in Table C-2 to Be Mathematical Errors . . . . .	38
C. Witness Prescott Unfairly Accuses Dr. Haldi of Error in Developing Test Year ECR Pound-Rated Mail Volumes . . . . .	39

D.	Witness Prescott's Criticism of Dr. Haldi's Assumption That Shipping Costs for Piece-Rated Mail Vary in Direct Proportion to Weight Are Really Criticisms of the Postal Service's Proposal Which He Claims to Support . . . . .	42
E.	Witness Prescott Criticizes Dr Haldi's Constant Margin of 8.119 Cents Per Piece and Constant Mark-up Ratio of 2.4405 and Their Use in a 90/10 Allocation . . . . .	45
F.	Witness Prescott Criticizes Dr. Haldi's Use of BMC Entry Point for the Development of His Proposed Rates . . . . .	47
G.	Witness Prescott States Incorrectly That Dr. Haldi Assumes the Pound Portion of Pound-Rated Mail Costs Does Not Vary with Sortation or Destination Entry . . . . .	48
H.	Witness Prescott's Criticism of Dr. Haldi's "True-up" Is Theoretically Sound, Is Empirically Insignificant . . . . .	49
I.	Witness Prescott Completely Misunderstands and Misconstrues Dr. Haldi's Use of Two Alternative Cases to Illustrate the Effect of Weight on Nonletter Piece Costs . . . . .	50
J.	The Number of Errors Witness Prescott Alleges in Dr. Haldi's Tables is Misleading in That Alleged Errors Are Said to be Errors Every Time the Numbers Ripple Through Subsequent Tables . . . .	53
K.	Witness Prescott Continues to Mislead by Complaining That Dr. Haldi Does Not Use the Unit Costs Developed Beginning with Table A-14 (and Subsequent Tables) in His Ultimate Rate Design for Pound-Rated Mail, Then Claiming That Dr. Haldi Does . . . . .	53
V.	OTHER INTERVENOR TESTIMONY PROPOSES CHANGES TO THE POSTAL SERVICE REQUEST FOR STANDARD A ECR WHICH WOULD BE COUNTER-PRODUCTIVE AND SHOULD NOT BE RECOMMENDED . . . . .	56
A.	Witness Clifton's Proposal To Increase Standard A Rates in Order To Reduce the Second and Third Ounce Rates of First-Class Workshared Mail Misapplies the Concept of Cross-Subsidy and Should Not Be Recommended	

1.	Witness Clifton Proposed Additional Increases to Standard A Commercial Rates . . . . .	56
2.	On Cross-examination, Witness Clifton Admitted Weaknesses in His Proposal . . . . .	58
3.	Witness Haldi's Rebuttal Testimony Exposed Additional Weaknesses of Witness Clifton's Analysis . . . . .	58
4.	Witness Crowder Also Probed Limitations and Revealed Defects in Witness Clifton's Testimony . . . . .	61
5.	Witnesses Andrew Demonstrates Further Errors in Witness Clifton's Testimony . . . . .	62
6.	Witness Clifton's Proposals Should Not Be Recommended by the Commission . . . . .	62
B.	Witness Chown's Proposed Alternative Methodology for Allocating Institutional Costs Either Adds a New Criterion to Section 3622(b) or Gives Excessive Weight to Her Private Definition of Fairness, and Should Be Rejected	
1.	Witness Chown Proposes An Alternative Methodology for Allocating Institutional Costs . . . . .	63
2.	On Cross-examination, Witness Chown Asserted that Her Opinion Was the Only Common-sense Standard of Fairness and Equity . . . . .	66
3.	Witness Haldi's Rebuttal Testimony Exposed Additional Weaknesses of Witness Chown's Methodology . . . . .	66
4.	Witness Chown's Proposed Institutional Cost Assignment Methodology Should not be Recommended by the Commission . . . . .	70

	<i>Page</i>
C. Witness Bentley's Proposals To Reduce First-Class Rates Are Not Justified by the Evidence in this Docket and Should Not Be Recommended . . . . .	71
D. Witness Bradstreet's Proposal To Increase the Standard A ECR Pound Rate is Not Justified and Should Not Be Recommended . . .	74
1. Witness Bradstreet Proposed Increases to the Standard A ECR Pound Rate . . . . .	74
2. Cross-examination Exposed Weaknesses in Witness Bradstreet's Testimony . . . . .	75
3. Rebuttal Testimony Exposed Additional Weaknesses in Witness Bradstreet's Testimony . . . . .	75
CONCLUSION . . . . .	77

## TABLE OF AUTHORITIES

	<i>Page</i>
 <u><i>Cases</i></u>	
<u>Direct Marketing Ass'n v. United States Postal Serv.</u> , 778 F.2d 96 (2d Cir. 1985) . . . .	63
<u>National Ass'n of Greeting Card Publishers v. United States Postal Service</u> , 462 U.S. 810 (1983) . . . . .	67, 69
<u>National Ass'n of Greeting Card Publishers v. United States Postal Service</u> , 569 F.2d 570 (D.C. Cir. 1976) . . . . .	69
 <u><i>Statutes</i></u>	
39 U.S.C. section 3622 . . . . .	1
39 U.S.C. section 3623 . . . . .	1
39 U.S.C. section 3622(b) . . . . .	21, 23-27, 63-64
39 U.S.C. section 3622(b) . . . . .	25
39 U.S.C. section 3622(b)(2) . . . . .	25, 29
39 U.S.C. section 3622(b)(3) . . . . .	29
39 U.S.C. section 3622(b)(4) . . . . .	26, 29, 54
39 U.S.C. section 3622(b)(5) . . . . .	29
39 U.S.C. section 3622(b)(6) . . . . .	29
 <u><i>Regulations</i></u>	
39 CFR section 3001.20a . . . . .	2
 <u><i>Opinions and Recommended Decisions</i></u>	
Docket No. MC95-1 . . . . .	13



	<i>Page</i>
Docket No. R78-1 . . . . .	25
Docket No. R84-1 . . . . .	25
Docket No. R87-1 . . . . .	25
Docket No. R90-1 . . . . .	25, 64
Docket No. R94-1 . . . . .	25, 69

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INITIAL BRIEF

OF

VAL-PAK DIRECT MARKETING SYSTEMS, INC.,  
VAL-PAK DEALERS' ASSOCIATION, INC., AND  
CAROL WRIGHT PROMOTIONS, INC.

**STATEMENT OF THE CASE**

**COURSE OF PROCEEDINGS**

On July 10, 1997, the United States Postal Service filed a request, pursuant to the Postal Reorganization Act (39 U.S.C. sections 3622 and 3623), for a recommended decision by the Postal Rate Commission on certain rates and fees, including proposals relating to Standard A Mail rates, as well as certain changes to the Domestic Mail Classification Schedule.

On July 11, 1997, the Commission issued a Notice of Filing of the Postal Service's submission, which Notice of Filing, *inter alia*, established procedures for the new docket (designated Docket No. R97-1) regarding consideration of the requested changes by the Commission (Order No. 1186).<sup>1</sup>

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<sup>1</sup> This case was to have been submitted to the Commission on brief by March 13, 1998 (*See* Presiding Officer's Ruling ("P.O. Ruling") No. 97-1/4 (Aug. 1, 1997)). Subsequently, however, certain discovery problems, occasioned by the efforts

In accordance with Order No. 1186 and Rule 20a of the Commission's Rules of Practice and Procedure (39 CFR section 3001.20a), Val-Pak Direct Marketing Systems, Inc., Val-Pak Dealers' Association, Inc., and Carol Wright Promotions, Inc. (d/b/a Cox Direct), each filed a Notice of Intervention on July 30, 1997. These three intervenors have proceeded jointly in this proceeding, and are referred to collectively as "Val-Pak/Carol Wright" and "VP/CW."<sup>2</sup>

### **The Postal Service's Request**

The Postal Service's Request for a Recommended Decision initiating this proceeding requested rate and fee changes affecting all classes of mail, and asserted that without those changes the Postal Service would incur a revenue deficiency of \$2.4 billion in the requested test year (FY 1998). According to the Postal Service's initial filing, the requested rates would generate a revenue surplus of approximately \$41.9 million in the test year.<sup>3</sup>

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of Postal Service witnesses to rely on unsponsored library references, were resolved by the Commission, allowing the Postal Service to supplement its case-in-chief. *See* Order No. 1201 (Nov. 4, 1997), p. 17. This led to additional discovery and resulting changes in some of the target dates set forth in Order No. 1186, with the deadlines for filing initial and reply briefs extended to April 1 and April 10, 1998, respectively. *See* P.O. Ruling No. 97-1/54 (Nov. 4, 1997) and P.O. Ruling No. 97-1/55 (Nov. 5, 1997).

<sup>2</sup> Val-Pak/Carol Wright incorporate herein by reference the Trial Brief they filed in this proceeding on February 10, 1998.

<sup>3</sup> The estimated TYAR revenue surplus was later reduced to \$35.6 million. USPS-T-9, p. 47 (revised 8/22/97).

The Postal Service's case-in-chief requested a number of changes in Standard A ECR rate design, including a reduction in the pound rate, and a zero percent pass-through of the letter-flat differential for Basic mail. The Postal Service proposed that the letter-flat differential for High-Density and Saturation mail be continued, with a 35 percent passthrough of the letter-flat differential for the High-Density and Saturation tiers. The Postal Service also proposed a residual shape (nonletter, nonflat) surcharge of 10 cents, which has little impact on ECR flat mail due to the very few nonletter, nonflat pieces within ECR.

#### **Discovery of the Postal Service's Case-in-Chief**

Counsel for Val-Pak/Carol Wright conducted written cross-examination of nine Postal Service witnesses with respect to their identified direct testimony.

Witness Tolley	USPS-T-6
Witness Panzar	USPS-T-11
Witness Hume	USPS-T-18
Witness Crum	USPS-T-28
Witness Daniel	USPS-T-29
Witness O'Hara	USPS-T-30
Witness Moeller	USPS-T-36
Witness Takis	USPS-T-41
Witness McGrane	USPS-ST-44

Counsel for Val-Pak/Carol Wright conducted oral cross-examination of the following three Postal Service witnesses, which appears in the record at the identified pages:

Witness O'Hara	Tr. 2/482-495
Witness Moeller	Tr. 6/3103-3123
Witness McGrane	Tr. 15/7808-7828

#### **Val-Pak/Carol Wright Direct Testimony**

Val-Pak/Carol Wright sponsored the direct testimony of Dr. John Haldi on Standard A Enhanced Carrier Route Mail (VP/CW-T-1) (Tr. 27/15038-165), filed December 30, 1997.<sup>4</sup> During discovery, a total of 51 interrogatories and requests for production of documents were propounded to Dr. Haldi by the Association of Alternative Postal Systems (AAPS/VP-CW-T1-1-2), the Mail Order Association of America (MOAA/VP-CW-T1-1-13), the Newspaper Association of America (NAA/VP-CW-T1-1-11), and the Postal Service (USPS/VP-CW-T1-1-25). The responses of Dr. Haldi to 49 of these interrogatories were designated as written cross-examination in the transcript (Tr. 27/15170-229).

On February 26, 1998, during the hearings there was no oral, cross-examination of Dr. Haldi on his direct testimony (Tr. 27/15230-31).

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<sup>4</sup> Certain revisions to the testimony of Dr. Haldi were subsequently filed as errata, before Dr. Haldi was orally cross-examined on February 26, 1998.

**Direct Testimony of Other Intervenors**

The American Bankers Association, Edison Electric Institute, and National Association of Presort Mailers sponsored the direct testimony of witness Clifton (ABA/EEI/NAPM-T-1) concerning the development of proposed rates for workshared First-Class letter mail (Tr. 24/12458-622). This testimony proposed to increase the cost coverage of Standard A Mail by 8 percent more than the Postal Service had requested. His oral cross-examination appears at Tr. 24/12695-12791.

The American Bankers Association and the Newspaper Association of America sponsored the direct testimony of witness Clifton (ABA/NAA-T-1) concerning his perception of an alleged “cross-subsidy” of Standard A Mail by First-Class Mail. (Tr. 21/10815-89.) This testimony proposed to increase the cost coverage for Standard A Mail by 3 percent more than the Postal Service had requested. His oral cross-examination appears at Tr. 21/10976-11074.

The Newspaper Association of America sponsored the direct testimony of witness Chown (NAA-T-1), in which she proposed a method of rearranging attributable costs, which she refers to as “weighted attributable costs,” which would likely increase the institutional cost contribution of Standard A ECR Mail (Tr. 25/13261-92). Her oral cross-examination appears at Tr. 25/13391-440.

The Association of Alternative Postal Systems sponsored the direct testimony of witness Bradstreet (AAPS-T-1), in which he opposed the Postal Service’s proposal to lower the ECR pound rate, and opposed the requested parcel surcharge when it is used

to support or justify a reduced ECR pound rate (Tr. 23/11977-12024). His oral cross-examination appears at Tr. 23/12063-74.

The Major Mailers Association sponsored the direct testimony of witness Bentley (MMA-T-1), which appears to seek increases in Standard A rates, as witness Bentley does not support the Postal Service's requested one-cent increase in the single-piece First-Class Mail one-ounce rate (and supports increasing the Service's requested discounts for First-Class Automation letters) (Tr. 21/11151-95). His oral cross-examination appears at Tr. 21/11280-318.

#### **Val-Pak/Carol Wright Discovery of Other Intervenors**

Val-Pak/Carol Wright submitted a total of 31 interrogatories and requests for production of documents to other intervenor witnesses. All 31 of the responses to the Val-Pak/Carol Wright interrogatories were designated as written cross-examination of these witnesses. These responses appear in the record as follows:

Clifton (VP-CW/ABA/EEI/NAPM-T1-1-9, Tr. 24/12683-92);

Clifton (VP-CW/ABA/NAA-T1-1-3, Tr. 21/10972-75);

Bradstreet (VP-CW/AAPS-T1-1-3, Tr. 23/12059-61);

Bentley (VP-CW/MMA-T1-1-5, Tr. 21/11260-79); and

Chown (VP-CW/NAA-T1-1-11, Tr. 25/13379-90).

Counsel for Val-Pak/Carol Wright orally cross-examined the following two intervenor witnesses on their direct testimony: Clifton (ABA/NAA-T-1) (Tr. 21/11019-50, 11072-73) and Chown (NAA-T-1) (Tr. 25/13412-34).

### **Rebuttal Testimony**

Val-Pak/Carol Wright sponsored the rebuttal testimony of Dr. Haldi (VP/CW-RT-1) (Tr. 32/17281-313). Dr. Haldi's rebuttal testimony critiqued: (i) witness Chown's (NAA-T-1) proposed methodology of "weighted attributable costs" for purposes of assigning institutional costs (Tr. 25/13261-92); and (ii) certain aspects of witness Clifton's testimony (ABA/NAA-T-1), including his assertions concerning an alleged cross-subsidy of Standard A Mail and his proposal to change the cost coverages for First-Class Mail and Standard A Mail (Tr. 21/10815-89).

In addition to Dr. Haldi, witness Chown's testimony (NAA-T-1) was rebutted by witness Crowder (ADVO-RT-1) (Tr. 34/18301-66), witness Andrew (MOAA, *et al.*-RT-1) (Tr. 36/19663-729), and three Postal Service witnesses, witness Christensen (USPS-RT-7) (Tr. 34/18212-46), witness Panzar (USPS-RT-13) (Tr. 34/18442-64), and witness Taufique (USPS-RT-21) (Tr. 34/18509-25).

In addition to rebuttal by Dr. Haldi, Witness Clifton's testimony (ABA/NAA-T-1) was rebutted by witness Crowder (ADVO-RT-1) (Tr. 34/18301-66) and witness Andrew (MOAA, *et al.*-RT-1) (Tr. 36/19663-729).

The Mail Order Association of America (MOAA) sponsored witness Prescott's rebuttal testimony (MOAA-RT-1) (Tr. 36/19505-46), which criticizes Dr. Haldi's direct testimony (VP/CW-T-1), asserting that it is fraught with errors and assumptions. This rebuttal testimony is analyzed at Section IV, *infra*. (MOAA had not availed itself of the opportunity to cross-examine Dr. Haldi orally on his direct testimony with respect to any



of these allegations.) No other party, including the Postal Service, filed rebuttal testimony against Dr. Haldi's testimony on Standard A ECR Mail. Counsel for Val-Pak/Carol Wright cross-examined witness Prescott on March 20 on his rebuttal testimony (Tr. 36/19547-79 and 19581-82).

### **SUMMARY OF ARGUMENT**

The Postal Service's request with respect to Standard A ECR rate design represents a sound proposal. Nevertheless, it is limited in not focusing on the individual postal products within Standard A ECR, and this does not include rates that are as cost-based as they could and should be. Val-Pak/Carol Wright, through the testimony of Dr. John Haldi, have developed proposed alternative rates for Standard A ECR Mail that provide the same revenues and contribution to institutional cost for the entire subclass as the rates proposed by the Postal Service. The rates proposed by Val-Pak/Carol Wright, however, in being developed using a bottom-up costing methodology, would result in more cost-based rates and a more reasonable contribution to institutional costs from each product (rate cell) in the subclass.

Dr. Haldi has developed the rates by combining "target margin" and a "target mark-up" to arrive at indicated rates, and then by balancing the noncost factors set forth in 39 U.S.C. section 3622(b) to arrive at final rates. In addition to ensuring that each product within the Standard A ECR subclass would cover its costs and make a reasonable contribution to institutional costs, the Val-Pak/Carol Wright-proposed rates reflect the level of competition that the Postal Service actually faces to provide various functions for Standard A ECR Mail, including delivery.

As Dr. Haldi demonstrates, rate design within the Standard A ECR Mail subclass should be based on application of the 39 U.S.C. section 3622(b) criteria to products within the subclass as well as to the subclass. Although the Postal Reorganization Act may not require application of those criteria below the subclass level, the Commission

has been willing to apply the section 3622(b) criteria to products within subclasses, when deemed appropriate. The Postal Service has also applied section 3622(b) criteria to rate categories, including individual rate categories with Standard A ECR in this docket. Cost coverages for products within a subclass should be based on the statutory criteria, not *ad hoc* rationalizations. The proposed cost coverage for Standard A ECR, a subclass which has a low economic value of service and high degree of mailer preparation, and for which competitive alternatives are available, is too high. This makes it even more necessary for the Commission to establish within the subclass mark-ups that do not excessively burden a particular product category, especially those with the most alternatives, Saturation mail.

Witness Prescott's criticisms of Dr. Haldi's proposals are overstated and themselves contain errors. Dr. Haldi's development of unit costs, margins, and mark-ups for each rate category within Standard A ECR is reasonable and based on the best available data.

Other intervenor testimony, suggesting changes to Postal Service's Standard A rate request, propose changes that would be counterproductive and should not be recommended.

**ARGUMENT****I. THE POSTAL SERVICE'S REQUEST FOR STANDARD A ECR RATES IS BASED UPON A CREDITABLE, BUT LIMITED, COSTING AND RATE DESIGN**

This is the first omnibus rate case in which the Postal Service has requested rates for the Standard A ECR subclass. Witness Moeller (USPS-T-36), the Postal Service's Standard A rate design witness in this docket, discusses Standard A ECR at pages 22 through 31 of his testimony. Witness Moeller employs the traditional top-down rate design methodology in designing requested rates for Standard A ECR Mail.

Among the changes in Standard A ECR rate design requested by the Postal Service are:

- changes in the rate design formula;
- increases in the pound-rated piece rates (3.2 cents for Saturation to 3.7 cents for Basic);
- a reduction in the pound rate (from 66.3 cents to 53 cents);
- a reduction in the destination entry discount passthrough (from 100 percent to 80 percent);
- elimination of the letter/nonletter rate differential in the Basic tier; and
- establishment of a residual shape surcharge.

The Postal Service's changes in the Standard A ECR rate design formula, as identified in witness Moeller's testimony, appear to be an improvement over the past. The new rate design formula establishes a rate above zero for a Saturation pound-rated piece entered at DDU. Witness Moeller explained that the changes were made to avoid the incongruity of two pound-rated, identical weight, Saturation mailpieces paying the

same postage as a single Saturation mailpiece entered at DDU which is twice as heavy. He noted that the Postal Service would presumably incur greater costs to process and deliver two 4 ounce pieces than to process and deliver one 8 ounce piece. USPS-T-36 , p. 24, ll. 7-23. This change allows for direct consideration of the appropriate pound rate. *Id.*, p. 23, ll. 17-18. The resulting increases in the pound-rated piece rate also appear reasonable, in conjunction with the reduction in the pound rate.

Additionally, the Postal Service's proposed ECR pound rate appears reasonable. Dr. Haldi accepted the Postal Service's proposed ECR pound rate in his bottom-up costing methodology. VP/CW-T-1, p. 52, ll. 2-3, Tr. 27/15091.<sup>5</sup> Witness Moeller explained at length why the Postal Service requested a lower ECR pound rate. USPS-T-36, pp. 24-26. He observed that the Postal Service's changes in its rate design formula, increasing the pound-rated per-piece rates, reduced the necessary contribution from the pound rate. *Id.*, p. 24, ll. 21-23. Additionally, witness Moeller also noted that past reliance on the pound rate to subsidize a changing shape mix between flats and parcels (as weight increases) is no longer justified for ECR, since ECR flats and parcels have been shown to have very similar average weights. *Id.*, p. 25, ll. 1-11. Finally, witness Moeller also observed that the proposed ECR pound rate recognized that ECR "is in a competitive market and is susceptible to diversion to alternative media. As such, the rate structure should be sensitive to, and priced competitively with, the alternatives." USPS-

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<sup>5</sup> Dr. Haldi's development of bottom-up costs also establishes the relationship between the pound rate and the minimum piece rate for nonletters, and thereby provides an alternative way to analyze the reasonableness of higher and lower pound rates. (See response to AAPS/VP/CW-T1-2, Tr. 27/15171-72.)

T-36, p. 26, ll. 3-5. This is a most significant factor, that deserves even greater attention in Standard A ECR rate design. Dr. Haldi has commented extensively on the need for the Postal Service's Standard A ECR rates to reflect competitive realities. VP/CW-T-1, pp. 43-46, Tr. 27/15082-85.

Witness Moeller's 80 percent passthrough of destination entry discounts is a step backward from the 100 percent passthrough of Docket No. MC95-1. USPS-T-36, p. 30, ll. 2-9; *see also Op. & Rec. Dec.*, Docket No. MC95-1, para. 5645. Under the Postal Service's request, the piece-rated DBMC discount would increase from 1.3 cents per piece to 1.5 cents per piece; the DSCF discount would stay at 1.8 cents per piece; and the DDU discount would stay at 2.3 cents per piece. The pound-rated DBMC discount would increase from 6.4 cents per pound to 7.2 cents per pound; the DSCF discount would increase from 8.5 cents per pound to 8.8 cents per pound; and the DDU discount would decrease from 11.1 cents per pound to 11.0 cents per pound.<sup>6</sup> Notwithstanding the reduction in passthrough, Dr. Haldi adopted these discounts in his testimony.

Witness Moeller's proposed Standard A ECR rates are, however, subject to the limitations of the top-down methodology he relied upon, and the evidence developed by the Postal Service. They are not as good as they could or should be.

Val-Pak/Carol Wright propose somewhat different Standard A ECR rates for the reasons discussed in the next section of the brief. If the Commission chooses not to adopt

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<sup>6</sup> The fact that a reduced passthrough in this docket results in substantially identical discounts to those recommended by the Commission in Docket No. MC95-1 vindicates Dr. Haldi's testimony in that docket that the Postal Service's destination entry discount estimates were understated.

Val-Pak/Carol Wright's rates, it would urge the adoption of the Postal Service's proposed rates for Standard A ECR.

**II. WITNESS HALDI PROVIDES THE COMMISSION WITH AN OPPORTUNITY TO RECOMMEND BOTTOM-UP COST-BASED RATES FOR STANDARD A ECR MAIL**

Dr. John Haldi submitted testimony in this docket on behalf of Val-Pak/Carol Wright concerning Standard A ECR Mail cost and rate design (VP/CW-T-1, Tr. 27/15038-165). In his testimony, Dr. Haldi presents detailed, rate cell-by-rate cell Standard A ECR Mail costs developed using the bottom-up method.<sup>7</sup> He also provides a detailed analysis of the Postal Service's requested rates for each Standard A ECR Mail rate cell based on these calculated costs. Using this approach, Dr. Haldi then develops and proposes rates for Standard A ECR Mail, analogous to the manner in which these rates were developed in Docket No. MC95-1. Witness Haldi's proposed rates are more cost-based than has been heretofore possible in a general rate case.

Dr. Haldi first explains the difference between calculating costs from the bottom up versus the top down, as applied to Standard A ECR Mail. Top-down costs for a workshared product are calculated by determining the base cost for the subclass, then subtracting the costs avoided by the workshared product. *See* VP/CW-T-1, p. 10, Tr. 27/15049. Bottom-up costs for workshared products are calculated by adding up the costs incurred by each product for every function performed. *Id.* According to Dr. Haldi, both methods of calculating costs for rate cells ideally should produce the same result: the average unit cost implicit in each rate cell. *Id.*, p. 11, Tr. 27/15050.

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<sup>7</sup> This is a direct result of the more detailed cost information provided by the Postal Service in Docket No. MC95-1 and the docket. *See* VP/CW-T-1, p. 12, ll. 1-13, Tr. 27/15050.



Dr. Haldi developed unit costs for each rate cell within Standard A ECR Mail using the bottom-up costing method described above. He first calculated unit transportation, processing, delivery, and other costs for Standard A ECR letters and nonletters at each level of mailer presortation and preparation. *Id.*, Table A-1, Tr. 27/15101.

For each rate cell within Standard A ECR letters, Dr. Haldi calculated the shipping and sortation costs for the various levels of destination entry and presort based on the Postal Service's estimates of costs avoided by dropshipment and worksharing. *Id.*, pp. 13-14, Tr. 27/15052-53. Treating costs avoided and costs incurred as "two sides of the same coin," Dr. Haldi calculated bottom-up unit costs for each rate cell for Standard A ECR letters. *Id.*, p. 14, Tr. 27/15053. He then made a final adjustment to these unit costs to conform with CRA totals. *Id.*

Because the Postal Service in its proposal has not presented reliable evidence on the relationship between weight and cost, determining average unit costs for Standard A ECR nonletters was not as straightforward as for Standard A ECR letters. Dr. Haldi therefore calculated two sets of unit costs for Standard A ECR nonletters: Case I based on the assumption that a **high** proportion of costs is weight related (2.33 cents per piece); Case II based on the assumption that a **low** proportion of costs is weight related (0.5825 cents per piece). By choosing two extreme possibilities, Dr. Haldi was able to calculate a range within which the actual unit costs for Standard A ECR nonletters would most likely fall. *Id.*, pp. 15-20. Tr. 27/15054-59.

Dr. Haldi next used the bottom-up unit costs for Standard A ECR Mail to evaluate the Postal Service's requested rates for each product within the subclass. By dividing the requested rate for each product within Standard A ECR Mail by the product's unit cost, he was able to determine the mark-up (or range of mark-up) implicit in the Postal Service's rates, and by subtracting unit costs from requested rates, he determined the requested margin (or range of margin) for each product. *Id.*, pp. 26-27, Tr. 27/15065-66. (These results are reproduced below, in Table 1 (implicit mark-ups) and Table 2 (implicit margins).)

**Table 1**

**Postal Service Requested Rates  
Standard A ECR Mail  
Implicit Mark-Ups  
(percent)**

		No Dest. Entry	DBMC	DSCF	DDU
Letters	Basic	113	99	101	99
	Automation	142	129	132	130
	High-Density	168	159	164	168
	Saturation	213	210	209	211
Nonletters	Basic	71 - 82	69 - 82	71 - 85	73 - 87
	High-Density	125 - 148	135 - 163	137 - 166	143 - 176
	Saturation	191 - 235	214 - 273	209 - 267	222 - 289

Source: VP/CW-T-1, pp. 27 and 30-31, Tr. 27/15066 and 15069-70.

Analyzing the Postal Service's rate request for Standard A ECR Mail, Dr. Haldi demonstrates that Saturation mail would contribute proportionately more per piece to institutional costs (with cost coverage equivalents from 291 percent to 389 percent depending on the entry point) than any other Standard A ECR Mail product.

**Table 2**

**Postal Service Requested Rates  
Standard A ECR Mail  
Implicit Margins  
(cents per piece)**

		No Dest. Entry	DBMC	DSCF	DDU
Letters	Basic	8.32	7.07	7.00	6.66
	Automation	9.63	8.38	8.31	7.97
	High-Density	8.97	7.85	7.76	7.52
	Saturation	9.11	8.06	7.84	7.53
Nonletters	Basic	6.78 - 7.41	6.09 - 6.71	6.07 - 6.70	5.93 - 6.56
	High-Density	8.51 - 9.14	7.92 - 8.55	7.81 - 8.43	7.66 - 8.29
	Saturation	9.26 - 9.89	8.59 - 9.22	8.32 - 8.95	8.14 - 8.76

Source: VP/CW-T-1, pp. 27 and 30-31, Tr. 27/15066 and 15069-70.

Furthermore, the margins and mark-ups in the Standard A ECR Mail subclass are not a result of consideration of each product's appropriate contribution to institutional

costs, but instead are derived from whatever indicated rates emerge from the subclass' "dizzying array of passthroughs." Surprisingly, under the Postal Service's requested rates for Standard A ECR Mail, those products which incur the least cost and are most susceptible to diversion (because they have the most non-postal alternatives available), namely Standard A ECR Saturation letters and nonletters, are called upon to make a greater per-piece contribution within the subclass (than both Basic and High-Density). VP/CW-T-1, p. 28, Tr. 27/15067.

Dr. Haldi also uses these bottom-up costs to arrive at the rates proposed by Val-Pak and Carol Wright for Standard A ECR Mail. These are more cost-based rates, with a more reasonable contribution to institutional costs from each product, than those developed by the Postal Service's requested rate design, since the top-down approach used by the Postal Service bases rates on various partial worksharing passthroughs, and unit costs by rate cell are never calculated. Dr. Haldi's bottom-up method of rate design, which starts with the unit cost in each rate cell, ensures that the rate for each product within Standard A ECR Mail is cost-based. *Id.*, pp. 38-39, Tr. 27/15077-78.

Dr. Haldi's proposed rates also mitigate slightly the egregiously high implicit mark-ups to some products within Standard A ECR Mail, most notably Saturation mail. As Table 3 shows, the Postal Service's implicit mark-ups for Saturation letters range from 209 percent to 212 percent, which equal a cost coverages of 309 percent to 312 percent. Dr. Haldi's bottom up rates, as discussed above, achieve slightly more reasonable mark-ups for Saturation mail, without unreasonably affecting the implicit

mark-ups in other standard Mail A ECR Basic products. The mark-ups implicit in Dr. Haldi's proposed Standard Mail A ECR letter rates are displayed below.

**Table 3**  
**Standard Mail A ECR Letters**  
**Implicit Mark-Ups in VP/CW Proposed Rates**  
**(percent)**

		None	DBMC	DSCF	DDU
Letters	Basic	126 %	113 %	116 %	114 %
	Automation	136 %	123 %	126 %	123 %
	High-Density	166 %	157 %	162 %	166 %
	Saturation	201 %	197 %	195 %	197 %

Source: VP/CW-T-1, p. 51, Tr. 27/15090.

Dr. Haldi compares two methods to calculate an appropriate contribution from each rate cell: adding a uniform amount to the cost of each product (a target margin), and adding to the unit cost of each product a uniform percentage of the product's unit costs (a target mark-up). *Id.*, pp. 40-41, Tr. 27/15079-80. Applying a target margin to costs results in rate differentials between products which equal the cost differentials between the products, and in this respect is generally similar to the top-down approach, in that it recovers the entire contribution to institutional costs from the delivery function,

and in effect prices the Postal Service's mail processing and shipping services at cost.

*Id.*, p. 41, Tr. 27/15080.<sup>8</sup> Applying a target mark-up, in contrast, results in rate differentials which can exceed cost differentials, and recovers a contribution to institutional costs from all functions, including delivery. *Id.*, pp. 41-42, Tr. 27/15080-81. Given the competitive situation for delivery of Standard A ECR Mail, Dr. Haldi proposes using a combination of the two methods.

Dr. Haldi proposes rates for Standard A ECR letters and nonletters based on: (i) a combination of a target margin and a target mark-up to arrive at indicated rates, and (ii) a balancing of the 39 U.S.C. section 3622(b) noncost criteria to arrive at final rates. *Id.*, p. 46, Tr. 27/15085. By this method, Val-Pak/Carol Wright's requested rates for Standard A ECR Mail ensure not only that each product within the subclass covers its costs and makes a reasonable contribution to institutional costs, but also that the subclass rate design reflects the level of competition that the Postal Service faces in various functions within Standard A ECR Mail, including mail processing, shipping, and *delivery*. In light of existing and evolving competition for delivery of hard copy advertising material, this is deemed a more realistic approach for establishing cost-based rates. The rates proposed by Val-Pak/Carol Wright for Standard Mail A ECR are shown below.

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<sup>8</sup> This is sometimes referred to as the Efficient Component Pricing paradigm, which assumes that the Postal Service has a complete monopoly over the delivery function, but faces competition for mail processing and transportation services.

Table 4

**VP-CW Proposed  
Standard A ECR Rates  
(in dollars)**

	No Destination Entry ----	BMC ----	SCF ----	DDU ----
<b>Letters</b>				
Basic	0.167	0.152	0.149	0.144
Automation	0.160	0.145	0.142	0.137
High-Density	0.142	0.127	0.124	0.119
Saturation	0.129	0.114	0.111	0.106
<b>Nonletters (piece-rated)</b>				
Basic	0.167	0.152	0.149	0.144
High-Density	0.150	0.135	0.132	0.127
Saturation	0.138	0.123	0.120	0.115
<b>Nonletters (pound-rated)</b>				
Per Piece:				
Basic	0.058			
High-Density	0.041			
Saturation	0.029			
Per Pound:				
Basic	0.530	0.458	0.442	0.420
High-Density	0.530	0.458	0.442	0.420
Saturation	0.530	0.458	0.442	0.420

Source: VP/CW-T-1, p. 48, Tr. 27/15087.

**III. RATE DESIGN WITHIN THE STANDARD A ECR SUBCLASS SHOULD CONSIDER THE APPLICATION OF THE 39 U.S.C. SECTION 3622(b) CRITERIA TO PRODUCTS WITHIN THE SUBCLASS**

The rate charged for every postal product/rate cell is obviously the sum of the unit cost for that cell and the contribution to institutional costs sought to be recovered from that cell. Dr. Haldi's testimony provides the Commission with the choice to determine whether it is better to develop the unit costs for each rate cell separately with margins/markups developed explicitly, or whether it is better to avoid focusing on unit costs of rate cells and allow cost coverages to be set implicitly. As Dr. Haldi illustrates, the current top-down methodology for ECR produces haphazard results, to say the least. *See* VP/CW-T-1, pp. 26-29, and Appendix B, Tr. 27/15065-8. Dr. Haldi proposes a method for designing rates within the Standard A ECR Mail subclass which: (i) ensures that all rates are cost-based by fully utilizing available bottom-up cost data; and (ii) ensures that each rate includes a reasonable contribution to institutional costs, based on the rate design criteria in 39 U.S.C. section 3622(b).

**A. The Commission and the Postal Service Have Applied the Section 3622(b) Criteria to Products Within Subclasses, When Appropriate**

Under 39 U.S.C. section 3622(b), the Postal Rate Commission is required to "make a recommended decision on the request for changes in rates and fees in each class of mail or type of service," "in accordance with" the policies of the Postal Reorganization Act, including the following "factors" or criteria:



- (1) the establishment and maintenance of a fair and equitable schedule;
- (2) the value of the mail service actually provided each class or type of mail service to both the sender and the recipient, including but not limited to the collection, mode of transportation, and priority of delivery;
- (3) *the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to that class or type plus that portion of all other costs of the Postal Service reasonably assignable to such class or type;*
- (4) the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters;
- (5) the available alternative means of sending and receiving letters and other mail matter at reasonable costs;
- (6) the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service;
- (7) *simplicity of structure for the entire schedule and simple, identifiable relationships between the rates or fees charged the various classes of mail for postal services;*
- (8) the educational, cultural, scientific, and informational value to the recipient of mail matter; and
- (9) such other factors as the Commission deems appropriate.

In the past, the Commission has at times declined opportunities to apply explicitly the section 3622(b) rate criteria to determine cost coverages for certain rate categories, preferring to apply the statutory criteria to develop cost coverages only at the subclass level. This issue first arose in Docket No. R78-1, when the Commission declined to apply all the section 3622(b) criteria when designing rates for the First-Class nonstandard surcharge for the reason that it was a rate category rather than a subclass. *Op. & Rec.*

*Dec.*, Docket No. R78-1, pp. 15-18. This approach was followed when the Commission again declined to apply all statutory criteria to the First-Class nonstandard surcharge in Docket No. R84-1 (*Op. & Rec. Dec.*, Docket No. R84-1, pp. 330-31). The policy continued in Docket No. R87-1 (application of rate criteria to the First-Class presort rate category and to third-class carrier route mail) (*Op. & Rec. Dec.*, Docket No. R87-1, pp. 453-58, 598) and Docket No. R90-1 (application of rate criteria to the First-Class presort rate category) (*Op. & Rec. Dec.*, Docket No. R90-1, pp. V-86-88).

In practice, however, the Commission has, from time to time, chosen to apply at least some section 3622(b) criteria to evaluate the implicit cost coverage charged to rate categories. For example, in Docket No. R90-1, the Commission applied the statutory criteria when determining the implicit cost coverage for the various proposed non-presorted, pre-barcode First-Class Mail rate categories. *Op. & Rec. Dec.*, Docket No. R90-1, pp. V-58-59. Recommending a discount of 2.0 cents despite estimated cost savings of 1.63 cents for First-Class non-presorted, pre-barcode mail, the Commission stated that the resultant margin “satisfies the fair and equitable standard of sections 3622 and 3623 of the [Postal Reorganization] Act.” *Id.* at V-58.

In Docket No. R94-1, the Commission used the criteria of the Act to reject a proposed freeze on discounts within Bulk Rate Regular, saying that such a freeze would “yield large increases for those mailers who do the most worksharing and small increases for those who do the least,” and that this result would be “unfair and inequitable, and contrary to sections 3622(b)(1) and (6).” *Op. & Rec. Dec.*, Docket No. R94-1, p. V-99.

For its part, the Postal Service has also been willing to apply the section 3622(b) criteria to support its proposals at the rate category level, albeit in an *ad hoc* manner. In Docket No. MC95-1, for example, Postal Service rate design witness Moeller based several requested passthroughs within Standard A ECR mail on some of the section 3622(b) criteria, including a 100 percent passthrough on destination entry discounts based on a high price sensitivity (which indicates value to mailers). USPS-T-18, Docket No. MC95-1, pp. 13-14. In this docket, witness Moeller repeatedly invokes individual section 3622(b) criteria to justify rates for individual Standard A rate categories or products. *See* VP/CW-T-1, pp. 22-23. For example, he repeatedly invokes the “need to temper the increase on any one rate category to customers” (criterion 4). *See* USPS-T-36, p. 10 (Standard A Regular minimum-per-piece 3/5 digit presorted automation flats); p. 13 (Standard A Regular parcels); p. 16 (“individual categories”); p. 17 (“individual rate categories”); p. 20 (Standard A Regular Basic); p. 28 (Standard A ECR Automation); p. 29 (Standard A ECR Basic); and 30 (Standard A ECR Basic).

Witness Moeller also mentioned:

- The “below cost rate problem” (criterion 3) — *Id.*, p. 12, (Standard A Regular parcels);
- The desire for simplicity in the rate structure (criterion 7) — *Id.*, pp. 13, 15 (Standard A Regular parcels); and
- His concern that the proposed surcharge not be perceived as “inappropriate or unfair” (criterion 1) — *Id.*, p. 13 (Standard A Regular parcels).

Witness Moeller, in his response to VP-CW/USPS-T36-5(a), discusses the need to consider the effect of rate increases (section 3622(b)(4)), and to “balance this factor with

the other criteria of the Act” when setting rates for rate categories below the subclass level (Tr. 6/2899).

Also, Postal Service witness Fronk defends adjusting passthroughs of shape-based cost differences based on the section 3622(b) criteria. Response to NDMS/USPS-T32-6 (Tr. 4/1498). For other rate categories, the Postal Service seems to design rates based on nothing but their relationship with other products’ rates, without any apparent concern for whether the requested rates cover costs or whether they result in a reasonable contribution by the product to institutional costs.

**B. Cost Coverages for Products Within a Subclass Should Be Based on the Statutory Criteria, Not *Ad Hoc* Rationalizations**

Val-Pak/Carol Wright do not disagree with the Commission’s historic view that application of the section 3622(b) criteria at the subclass level (and no lower) minimally satisfies the statutory requirement that the Commission use the criteria to recommend rates for “each class of mail and type of service.” For some subclasses, though, mere satisfaction of the statutory requirement is not enough to ensure that rates charged are: (i) cost based; and (ii) based on the rate design principles embodied in section 3622(b). Also, as discussed *infra*, the “dizzying array of passthroughs” (VP/CW-T-1, p. 38, Tr. 27/15077) used by the Postal Service in this docket to design rates for products in Standard A ECR Mail results in implicit coverages that have little or no relationship with the subclass coverage level determined by application of the section 3622(b) criteria.

A crucial difference exists between the rate categories for which express application of the statutory criteria has been previously rejected by the Commission, and at least some rate categories within Standard A ECR mail as they exist in 1998. Application of the statutory criteria below the subclass level may be viewed as a luxury where the Postal Service faces no actual or potential competition for delivery, and therefore can recover all of its institutional costs from the rate it charges for final delivery. However, this is not the competitive situation which the Postal Service faces with respect to Standard A ECR, where especially Saturation mail faces some actual competition, and even greater potential competition.<sup>9</sup>

Also, as Dr. Haldi said in his direct testimony, the issue is not whether rate categories should be assigned individual cost coverages and thus “treated as subclasses,” but whether the cost coverages for products within a subclass will be assigned in an arbitrary manner (sometimes invoking whichever criteria justify the desired result, sometimes ignoring the criteria altogether) or in a systematic, rational, even-handed, and predictable manner. (VP/CW-T-1, p. 39, Tr. 27/15078.)

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<sup>9</sup> In this docket, several intervenors compete directly with the Postal Service for delivery of direct advertising, most notably the Association of Alternate Postal Systems, “a trade association of approximately 100 private, door-to-door delivery companies located in 30 states...all of whom compete with the USPS for delivery of Standard ECR saturation or high density advertising.” (AAPS-T-1, p. 5, ll. 14-15, 21-22, Tr. 23/11981.) Newspaper inserts are another competitive alternative to ECR Saturation mail.

**C. The Cost Coverage Requested by the Postal Service for Standard A ECR Letters Has Little Relationship with the Actual Implicit Cost Coverage Paid by Mailers of Discrete Products**

In this docket, Postal Service witness O'Hara (USPS-T-30) testified regarding application of the section 3622(b) criteria to the Postal Service's requested cost coverage for each class and subclass. For Standard A ECR, Dr. O'Hara discussed the subclass' value of service (section 3622(b)(2)), the effect on mailers of the requested increase (section 3622(b)(4)), the availability of alternatives (section 3622(b)(5)), the degree to which ECR mail is prepared by the mailer (section 3622(b)(6)), and the subclass' attributable cost (section 3622(b)(3)) and the resulting 228 percent cost coverage. (USPS-T-30, pp. 34 to 37.) But as Dr. Haldi's bottom-up costing makes clear, this carefully determined coverage level of Dr. O'Hara is only a subclass-wide average, and does not necessarily apply to any specific rate cells (*i.e.*, products) within the Standard A ECR Mail subclass.

Dr. O'Hara's analysis of the characteristics of Standard A ECR Mail concluded that a coverage factor of 228 percent was appropriate for all Standard A ECR Mail products. Since the relationship between the subclass-wide average, cost coverage and the coverages of products within the subclass is indirect at best, no Standard A ECR Mail products carry Dr. O'Hara's appropriate coverage factor, much less coverage factors based on their distinctive characteristics. The following chart displays the implicit cost coverages requested by the Postal Service for Standard A ECR letters. (Rate cells with **below** ECR Subclass average coverage of 228 percent (all of the Basic tiers) are bolded.)

**Table 5**

**Postal Service Requested Implicit Coverage Factors  
for Standard A ECR Letters**

	<b>No Dest. Entry</b>	<b>BMC</b>	<b>SCF</b>	<b>DDU</b>
<b>Automation</b>	242%	229%	232%	230%
<b>Basic</b>	<b>213%</b>	<b>199%</b>	<b>202%</b>	<b>199%</b>
<b>High-Density</b>	268%	259%	264%	268%
<b>Saturation</b>	313%	310%	309%	311%

The ECR Subclass already had the highest cost coverage of any subclass, despite the fact that Postal Service witness O'Hara stated that:

The availability of alternatives (criterion 5) for users of ECR mail is relatively high; due to its geographic concentration, both alternate delivery firms and newspaper inserts may provide alternative ways of delivering the same advertising message. [USPS-T-30, p. 35, ll. 14-17.]

Postal Service witness Moeller agreed, stating that:

the Enhanced Carrier Route subclass is in a competitive market and is susceptible to diversion to alternative media. As such, the rate structure should be sensitive to, and priced competitively with, the alternatives. [USPS-T-36, p. 26, ll. 3-5.]

Paradoxically, even within this subclass with the greatest coverage, the Standard A ECR products paying the highest coverage levels, saturation, also have the most alternatives to the mail. Saturation mail, which is most susceptible to diversion, should not pay rates based on implicit coverage factors which all are over 100 percentage points higher than the coverage factor for basic mail, and at least 82 percentage points higher than the subclass-wide coverage factor for ECR mail. Dr. Haldi's proposed method of rate design

for Standard A ECR would make express that which is now implicit. Also, by replacing the Efficient Component Pricing paradigm with one that allows competition for delivery service to be taken into account, it would set postal rates which will serve the Postal Service well in the increasingly competitive environment in which it operates. (*See* VP/CW-T-1, p. 49-50, Tr. 27/15088-89.)



**IV. IN HIS REBUTTAL TESTIMONY, MOAA WITNESS PRESCOTT PROVIDED NEITHER MEANINGFUL NOR SUBSTANTIVE REFUTATION OF DR. HALDI'S DEVELOPMENT OF BOTTOM-UP COSTS FOR ECR LETTERS AND NONLETTERS AND DR. HALDI'S SUBSEQUENT PROPOSED RATES**

Witness Prescott fails to refute either the logic or mathematics contained in Dr. Haldi's cost analysis and rate proposal. To the contrary, witness Prescott's rebuttal testimony is filled with errors, omissions, and misstatements.

Even witness Prescott's explanation concerning the purpose of his rebuttal testimony is somewhat misleading. At the beginning of his rebuttal testimony, witness Prescott asserts his purpose is to analyze the appropriateness of the adjustments proposed by Dr. Haldi to the Postal Service rate schedule for the ECR subclass. (Tr. 36/19508, ll. 2-5.) Dr. Haldi is not proposing adjustments to the rate schedule proposed by the Postal Service. Instead, Dr. Haldi presents an entirely different method for analyzing costs and developing rates, in lieu of that presented by the Postal Service. Therefore, it is inaccurate for witness Prescott to say he is analyzing Dr. Haldi's "adjustments."

**A. Witness Prescott Inaccurately Asserts That Dr. Haldi Relies on Overall Average Transportation and "Other" Costs for Letters and Flats Combined**

Witness Prescott says that Dr. Haldi incorrectly relies on Test Year overall average volume for letters and flats combined for the transportation component (0.1877 cents per piece) and the "other" component (0.4519 cents per piece) in Dr. Haldi's Table A-1. (Tr. 36/19534, ll. 3-5.) He implies that this development of Test Year costs is used throughout the development of individual costs by Dr. Haldi. Witness Prescott does

admit that these two components reflect only approximately 10 percent of the overall unit costs. His assertion that this criticism renders Dr. Haldi's results meaningless is without foundation. As witness Prescott acknowledged during oral cross-examination, Dr. Haldi does not rely anywhere in the development of his costs on the average transportation or other costs in his Table A-1. Witness Prescott admitted that Dr. Haldi's development of costs in Tables A-1 and A-2 was only an initial benchmark and not the totality of his analysis (Tr. 36/19552, ll. 2-7). Upon further cross-examination, witness Prescott admitted that Dr. Haldi developed shape-based unit shipping costs at a later point in his analysis, and that **the Postal Service did not provide costs separated between letters and nonletters**, which appeared to be the very basis for witness Prescott's criticism of Dr. Haldi's Table A-2. (Tr. 36/19553, ll. 10-24, emphasis added.)

Witness Prescott faults Dr. Haldi for not strictly using the projections provided by the Postal Service in Table A-1, and "The lack of support for one of the underlying unit costs in his analysis renders his results meaningless." (Tr. 36/19534, ll. 12-13.) He continues his criticism of Table A-2 by stating "Because of the errors in Table A-1, the separation of the costs between letters and nonletters cannot be validated." (Tr. 36/19534, ll. 17-18.) Thus, because Dr. Haldi interpolated certain of the unit costs in Table A-1 — costs comprising no more than 10 percent of the total, and costs not provided by the Postal Service (but which closely match the total CRA costs as presented by witness Patelunas (USPS-T-15), witness Prescott contends that Dr. Haldi's results are meaningless.

Witness Prescott admits that the Postal Service fails to distinguish costs between letters and nonletters, and asserts that any attempt to develop such costs is faulty because such costs cannot be proven in light of the Postal Service's failure to provide them. (*See* witness Prescott's fn. 1 at Tr. 36/19533.) The premise underlying witness Prescott's criticism seems to be that no one other than the Postal Service can develop costs or other information from Postal Service data.

Dr. Haldi, within the framework of the information provided by the Postal Service, has presented the Commission with an alternative, bottom-up method of developing unit costs on which to base rates. Wherever the Postal Service has failed to develop or provide cost distributions, Dr. Haldi has been forced to interpolate, using the information provided. He has consistently endeavored to develop Test Year costs as close as possible to data provided by the Postal Service, using actual Postal Service cost projections wherever possible. Witness Prescott asserts that, because Dr. Haldi has been forced to interpolate certain unit costs **totaling less than 10 percent of total unit costs**, *Dr. Haldi's entire analysis is meaningless*. Such a baseless charge does not assist the Commission. Even if the Commission were to adjust the 10 percent of total unit costs presented by Dr. Haldi which the Postal Service did not provide, any such adjustment would be minimal and the overall result would be inconsequential.

**B. Witness Prescott's Assertion of Mathematical Errors is Faulty**

**1. Witness Prescott Admits the Correction of Alleged Mathematical Errors by Dr. Haldi Would Have Minimal Impact on the Rates He Proposed**

Witness Prescott, in describing what he considers mathematical errors in Dr. Haldi's Appendices A and C, candidly admits in the beginning of his own Appendix B:

While the correction of mathematical errors apparently would have little impact on the rates proposed by Witness Haldi, I have identified all the errors that I have found in order to provide as complete a record as possible. [Tr. 36/19533, ll. 11-12.]

Under cross-examination, Witness Prescott admits to finding only three asserted mathematical errors in Dr. Haldi's testimony — in Tables A-8 and Table A-15 of Dr. Haldi's Appendix A and in Table C-2 of Dr. Haldi's Appendix C. Further, witness Prescott stated that correcting these asserted errors would have an impact of approximately a tenth of a cent on the [proposed] rate structure (Tr. 36/19549, ll. 2-6).

Actually, when examined carefully, two of the mathematical errors asserted by witness Prescott are not errors at all.

**2. Witness Prescott Makes Much Ado About Nothing in His Alleged Error of a 0.005 Cent Per-Pound Correction**

Witness Prescott presses his claim of a mathematical error in Table A-8 by stating that Dr. Haldi's error was:

The nontransportation costs for SCF shown by witness Haldi equals 0.72 cents per pound and is not correct. The actual value from the USPS' Library Reference LR-H-111 equals 0.73 cents per pound. [Tr. 36/19536, l. 17 through 36/19537, l. 2.]

On cross-examination, however, witness Prescott was asked where he obtained the 0.073 cents per pound figure, to which (referring to USPS Library Reference LR-H-111) he replied, "Appendix C, table 1, revised November 20, 1997." (Tr. 36/19564, l. 13.) When asked whether his criticism was the failure to recognize the revision in Library Reference LR-H-111, he replied "yes." (Tr. 36/10565, l. 10.) The cross-examination continued:

Q. By the penny.

A. Yes.

Q. And you realize that the number you cite, you do have that page you cited; correct?

A. Yes

Q. The bottom of table 7?

A. The page that I have doesn't have a table 7 on it. I'm looking at Appendix 7, table 1.

Q. Right. Appendix 7, Table 7 has a number carried out to more decimal points. It's [\$]0.007264. Dr. Haldi used 0.72 [cents]. You used 0.73 [cents]. Correct?

A. Yes. [Tr. 36/19565, ll. 11-22.]

In point of fact, the revision to which witness Prescott refers was not even available when the tables in Dr. Haldi's Appendix A were developed.<sup>10</sup> Witness Prescott's complaint that Dr. Haldi did not update his table with a single number out of

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<sup>10</sup> When the library reference was revised on November 20, 1997, the number \$0.007264 was reduced to \$0.007258, which is actually closer to the 0.72 cents Dr. Haldi used.

the Postal Service's voluminous revisions of its library references seems hardly worthy of mention. At most, the difference between Dr. Haldi's 0.72 cents for unit nontransportation costs for SCF entry and the subsequently revised amount of 0.7258 cents would have an infinitesimal impact on the overall cost analysis presented by Dr. Haldi.

This assertion of mathematical error is nothing more than a weak effort to cast doubt on the veracity of Dr. Haldi's cost analysis. It has little impact on Dr. Haldi's results and should be given no weight.

### **3. Witness Prescott Finds an Error of Transposition in Table A-15 Which He Claims is a Mathematical Error**

In Table A-15, witness Prescott did find an actual error. The total weight given in Table A-15 for pound-rated mail is slightly misstated. However, witness Prescott does not analyze this error, or its impact on the subsequent development of individual and overall costs under Case I. There is no impact whatsoever. The unit cost and total cost presented in Tables A-18 and A-19 do not change when the correct total number of pounds is inserted (3,892,997,662 for pound-rated mail in lieu of the stated amount of 3,908,681,279).

Secondly, witness Prescott acknowledged that the cost development of Table A-14 and subsequent tables had no effect on the rate proposal developed by Dr. Haldi in Appendix C. (Tr. 36/19540, ll. 17-18.) He seems to complain that the costs developed for nonletter mail have no bearing on the rate proposal, then takes issue with their development anyway. He apparently is of the view that a typographical error which has

no bearing on the ultimate unit and total costs developed in Case I is a reason for dismissing the totality of Dr. Haldi's work.

**4. Witness Prescott Exaggerated Dr. Haldi's Constant Margin of 8.119 Cents Per Piece and Constant Mark-up Ratio of 2.4405 in Table C-2 as Mathematical Errors**

Witness Prescott takes issue with Dr. Haldi's use of a constant margin of 8.119 cents per piece and constant mark-up ratio of 2.4405, in three ways. First, witness Prescott calls them mathematical errors. Second, witness Prescott faults Dr. Haldi for using these particular constants rather than any others. Third, witness Prescott states that Dr. Haldi fails to provide a basis for using these constants. (The second and third criticisms will be covered, *infra*.)

Witness Prescott faults the above numbers because, when Dr. Haldi filed his errata, he did not change the numbers used for a constant margin of 8.019 cents per piece and a constant mark-up ratio of 2.4089. While witness Prescott is technically correct, he fails to mention that the impact of this "mathematical error" on the rates proposed by Dr. Haldi would be infinitesimal.<sup>11</sup>

Witness Prescott takes pains to criticize the "mathematical error" in Table A-15. First, the error was of transposition from Table A-7, not a mathematical error, *per se*. Second, the impact on the final unit costs presented in Table A-18 and total nonletter

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<sup>11</sup> Nowhere in his presentation does witness Prescott calculate the impact on Dr Haldi's proposed rates of the corrections of asserted mathematical errors.

costs presented in Table A-19 (Case I) is zero. The costs do not change when this error is corrected.

**C. Witness Prescott Unfairly Accuses Dr. Haldi of Error in Developing Test Year ECR Pound-rated Mail Volumes**

Witness Prescott sees fit to take issue with Dr. Haldi on the development of Test Year pound-rated mail volumes in Table A-6.

Witness Haldi's separation of total pieces for ECR pound-rated mail by destination entry profile in Table A-6 is based on the USPS' separation of the pounds by destination entry profile. [Tr. 36/19535, ll. 5-7.]

Witness Prescott accuses Dr. Haldi of misusing the data provided by the Postal Service in witness Moeller's workpaper 1, page 20. He faults Dr. Haldi for not using the Base Year weights in Dr. Haldi's Table A-5 for pound-rated mail, instead of witness Moeller's percentage distribution. Witness Prescott's analysis is inaccurate.

For example, high-density mail entered at the BMC had a 1996 average weight of 0.21 pounds per piece which reflects a 29 percent reduction from Witness Haldi's value of 0.34 pounds per piece. His assumption regarding pounds is false based on the same 1996 Billing Determinant data that he used elsewhere in his analysis. [Tr. 36/19535, l. 16 through 36/19536, l. 2.]

Not only does witness Prescott make an impossible criticism that Dr. Haldi should have attempted to project Base Year weights to Test Year data, but he offers no evidence to buttress his assertion. He makes a small error himself in asserting that BMC Base Year pound weight per piece was 0.21 pounds, rather than the actual 0.2417 pounds.



Witness Prescott assumes that the Test Year will have the same distribution as the Base Year. Nowhere does he offer any evidence that this would be the case, yet he argues that Dr. Haldi is incorrect for not acting upon this assumption.

He was asked: “Witness Moeller in that workpaper or anywhere else in this case, I think you will confirm, did not provide piece break outs for pound-rated pieces, whether they be flats — whether they be in the Standard A Regular or ECR sub-class, he didn’t provide a piece break out for pound-rated pieces, correct, by point of entry, BMC, SCF or DDU?” Witness Prescott answered, “Witness Moeller did not; that’s correct.” (Tr. 36/19554, ll. 13–19.)

In fact, there is no evidence whatsoever as to whether witness Moeller did or did not rely on Base Year weights for the development of Test Year weights for pound-rated mail, or for pound-rated mail distribution, either in his Workpaper 1 or anywhere else. Witness Prescott’s criticism is that Dr. Haldi has used witness Moeller’s Test Year projections.

Witness Moeller’s Test Year projections are the basis for the rates proposed by the Postal Service. Witness Prescott finds no fault in the Postal Service using witness Moeller’s Test Year projections; his finding fault with Dr. Haldi’s use of the same projections is inconsistent at best.

Regarding Table A-1, witness Prescott had criticized Dr. Haldi for interpolating Postal Service data and developing costs which the Postal Service did not provide. Here, he criticizes Dr. Haldi for accepting Postal Service data.

Witness Prescott suggests that using Base Year weight distribution for pound-rated mail would be a preferable method for developing Test Year per-piece distribution. However, witness Prescott, as he admitted in cross-examination, has not made any attempt to fit Base Year weight distribution into a Test Year per-piece distribution using the pound-rated mail weights and total pieces from witness Moeller's Workpaper 1, page 20. (Tr. 36/19556, ll. 14-15.) Witness Prescott advocates a methodology he has failed to employ, or even test. He has no knowledge whether it would work, as he admitted under cross-examination. (Tr. 36/19554, l. 4, to 36/19556, l. 15.) Yet he would fault Dr. Haldi's method without presenting an alternative he has tried and proven — or even tried at all.

Witness Prescott further admitted there are no systematic variations in average Base Year pound-rated mail weights in Dr. Haldi's Table A-5 either by point of entry or sortation. He was unable to develop any rational explanation for the variation in weights between level of sortation and destination entry other than the weights were actual Fiscal 1996 data. Yet witness Prescott would have the Commission believe that the use of Base Year weights is somehow preferable to using witness Moeller's Test Year projections.

When pressed further, witness Prescott acknowledged that there are other methods for allocating the Test Year distribution for pound-rated mail:

- A. You could do a time series. You could test the values over time. You could do a regression. You could take the test year pieces and adjust them based on the test year pounds but recognizing variations in weight.
- Q. Do you know if you can do any of those with the information that's been provided so far in this case by the Postal Service?

A. I don't know.

Q. Have you tried to do any of those?

A. No. [Tr. 36/19560, l. 18 through 36/19561, l. 2.]

Finally, witness Prescott states, "Witness Haldi's analysis of the costs associated with weight as utilized in Table A-14 (or subsequent Tables) have no bearing on his ultimate rate design for pound-rate mail." (Tr. 36/19540, l. 17 through 36/19541, l. 1.)

Witness Prescott asserts that Dr. Haldi should not have relied on the Postal Service projections without presenting an alternative method which worked. Witness Prescott's criticisms regarding Dr. Haldi's assumptions in Table A-6 should be given no weight.

**D. Witness Prescott's Criticism of Dr. Haldi's Assumption That Shipping Costs for Piece-Rated Mail Vary in Direct Proportion to Weight are Really Criticisms of the Postal Service's Proposal Which He Claims to Support**

Witness Prescott criticizes Dr. Haldi's assumption "that shipping costs for piece-rated mail (*i.e.*, below 3.3 ounces) vary in direct proportion to weight. This assumption has not been shown to be valid and, in fact, is refuted by the data shown in Witness Haldi's Appendix D." (Tr. 36/19537, ll. 12-14.) He further states that "Witness Haldi's Appendix D, which is based on Library Reference LR-H-182, shows that a carrier route letter mail weighing 1 ounce costs more than letters weighing from 2 to 4 ounces." (Tr. 36/19537, footnote 4.)

Witness Prescott either does not understand Dr. Haldi's Appendix D, or the Postal Service's LR-H-182, or both. The purpose of Dr. Haldi's Appendix D is to

discuss shortcomings in Library Reference LR-H-182 and the need for adequate studies to determine the weight/cost relationship for bulk mail. Witness Prescott's assertion that the LR-H-182 data in Appendix D invalidate Dr. Haldi's assumption that shipping costs vary in direct proportion to weight reflects a complete misunderstanding of Dr. Haldi's testimony, especially Appendix D.

Under cross-examination, witness Prescott admitted that he was familiar with LR-H-111. When asked how the drop ship savings for Standard A Mail were developed, witness Prescott admitted that these drop savings were on a per-pound basis, as opposed to a per-piece basis. He qualified his acceptance by stating "I **don't know** if every single one is [referring to the drop ship savings in LR-H-111]. Generally — the answers are expressed on a per-pound basis." (Emphasis added.) When asked if he had a problem with LR-H-111 and the way the Postal Service develops drop ship savings, he answered "No." (Tr. 36/19566, ll. 4-25.)

On further cross-examination, witness Prescott stated that his reference to Dr. Haldi's refutation of his own testimony in Appendix D was based on Table D-3. When asked whether he had read Dr. Haldi's discussion of Table D-3 on page D-9, where Dr. Haldi states that the results presented in Table D-3 are "absurd," witness Prescott said he had read that section.<sup>12</sup>

Witness Prescott stated that he was not sure that Dr. Haldi was claiming that all the data in these tables are absurd. Again, when pressed further, witness Prescott finally

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<sup>12</sup> For the complete cross-examination on this point, refer to Tr. 36/19565, l. 23 through 36/19569, l. 8.

admitted that Dr. Haldi's analysis of Tables D-2 and D-3 (at least) stated that the results were absurd and cannot be given serious weight.

Witness Prescott's criticism of Dr. Haldi's assumption that shipping costs (for piece-rated mail below 3.3 ounces) vary in direct proportion to weight has no basis, and, as demonstrated herein, his assumptions are wrong.

Although witness Prescott claims to understand LR-H-111, his reluctance to admit the weight/cost relationship in the drop ship savings (applied on a per pound basis) demonstrates a casual understanding of LR-H-111 or a lack of confidence in that study.

Witness Prescott is content to criticize assumptions with which he disagrees (or does not understand) without offering any alternative. Witness Prescott has failed completely to refute Dr. Haldi's premise that weight below the breakpoint has a direct role in determining shipping cost.

Witness Prescott, by inference, is correct in pointing out that the Postal Service has neither developed nor presented evidence of the true cost differential in transporting Standard A Mail (or other mail), other than its development of drop ship savings in LR-H-111.

If witness Prescott had any evidence refuting Dr. Haldi's assumption that weight affects unit transportation costs for piece-rated pieces, he could have presented it. He did not.

**E. Witness Prescott Criticizes Dr Haldi's Constant Margin of 8.119 Cents Per Piece and Constant Mark-up Ratio of 2.4405 and Their Use in a 90/10 Allocation**

Witness Prescott faults Dr. Haldi's choice of 8.119 as a constant margin and 2.4405 as a constant ratio and his decision to allocate 90 percent to a constant mark-up and only 10 percent to a constant margin. Witness Prescott says this allocation is arbitrary and unsupported.

But Dr. Haldi does provide full support for such an allocation in the text of his testimony. It may be arbitrary, as Dr. Haldi admits, but it certainly is not unsupported. Beginning on page 40 of Dr. Haldi's text (Tr. 27/15079), he analyzes target margins versus target mark-ups. He continues this discussion of pricing strategies and competitive environments, concluding with his rationale for allocating 90 percent of his proposed initial rates to a constant margin and 10 percent to a constant mark-up ratio. While the Commission may prefer a different allocation between margin and mark-up, Dr. Haldi's position is clearly supported by reason.

In fact, Dr. Haldi observed that "The extent to which either of these two approaches [margins or mark-ups], is more appropriate for any given class or subclass depends on the competitive environment for postal services, as explained below." (Tr. 27/15079, ll. 13-16.) Dr. Haldi discusses his concepts of margins, mark-up, the competitive environment and pricing strategies at length, and explains in detail why he chooses the 90/10 allocation. It is Dr. Haldi's reasoned choice in developing the rates he proposes. Presumably, witness Prescott would have the Commission pretend that the Postal Service has an absolute monopoly over delivery of ECR mail.

Yet, witness Prescott takes issue, stating “I don’t believe either of these two approaches is appropriate from the standpoint of his analysis.” (Tr. 36/19576, ll. 16-18.) When confronted with relevant portions of Dr. Haldi’s testimony, witness Prescott’s fall-back position was that Dr. Haldi’s approach is not “quantitative.” Tr. 36/19578, l. 14. Again, witness Prescott proposes no alternative, and offers no specific basis for his rejection of Dr. Haldi’s reasoned approach. Nowhere in witness Prescott’s presentation does he offer any alternative to Dr. Haldi’s analysis or proposed rates.

The essence of valid criticism is the logical explanation of the criticism coupled with an alternative, either in approach or solution. Witness Prescott offers none of these. Yet, he calls on the Commission to disregard Dr. Haldi’s analysis and proposed rates while he offers none.

But witness Prescott fails in his criticism of Dr. Haldi’s 90/10 allocation. When asked if the allocation were different, say 80/20, then the Basic rates, which witness Prescott wishes to minimize, would be higher, he was finally forced to concede that:

[A]s you decrease the constant piece and increase the ratio piece, Part C of his Table C-2, the basic rate, would increase. [Tr. 36/19579, ll. 21-23.]

The net result of witness Prescott’s criticism of Dr. Haldi’s 90/10 allocation would be an increase in the Basic rates used by catalog mailers. As admitted by witness Prescott, lowering the constant margin allocation and increasing the constant ratio allocation would increase the mark-up on processing and transportation and lessen the mark-up on the delivery function. This reallocation would increase the Basic rate. The

greater the reallocation, the greater would be the effect on the Basic rate, allocating more to the processing and transportation functions, and reducing the allocation to delivery.

Were Witness Prescott to advocate a 70/30 allocation, or even an 80/20 allocation, the effect would be to raise Basic rates. Thus, witness Prescott only criticized the allocation, without presenting an alternative.

**F. Witness Prescott Criticizes Dr. Haldi's Use of BMC Entry Point for the Development of His Proposed Rates**

Witness Prescott takes issue with Dr. Haldi for using BMC Entry as the basis for developing his initial target proposed rates in Table C-2(d), and for presenting his rate proposal based solely on the bottom-up costs of BMC mail. However, witness Prescott presents no analysis of what differences might result if other entry points were used. Such an analysis should not be difficult to produce, yet witness Prescott made no attempt to prepare one. (Tr. 36/19575, ll. 17-20.)

Dr. Haldi did not present alternative analyses for the very reason that they would add nothing to his rate proposal. Additional presentations based on other points of entry — SCF, DDU, or No Destination Entry — would only tend to confuse Dr. Haldi's presentation. The differences would be *de minimis*. Just as the differences in results which might be achieved by correcting for witness Prescott's alleged mathematical errors, any differences in the rates proposed by Dr. Haldi through relying on a different point of entry would be minimal. Yet witness Prescott would have the Commission dismiss Dr. Haldi's analysis.



**G. Witness Prescott States Incorrectly That Dr. Haldi Assumes the Pound Portion of Pound-rated Mail Costs Does Not Vary With Sortation or Destination Entry**

Witness Prescott makes an erroneous criticism of Dr. Haldi's analysis relating to pound rates. First, he assumes that the per-piece portion of the costs for pound-rated mail does not vary by destination entry (*e.g.*, the costs for Saturation nonletters with no drop shipping equals the costs for Saturation letters dropshipped to the DDU). Second, for the pound portion of pound-rated mail, witness Haldi assumes that costs do not vary with sortation or destination entry (*e.g.*, the pound portion of pound-rated mail for Basic sortation without drop shipping is the same as the pound portion for Saturation mail dropshipped to the DDU). (Tr. 36/19541, l. 13 through 36/19542, l. 2.)

This assertion is incorrect. On cross-examination, witness Prescott was asked to find the pound portion of pound-rated mail in Dr. Haldi's Table A-16. Witness Prescott replied "For basic mail it is 0.257." (Tr. 36/19573, l. 10.) He was then asked for the number for Saturation mail dropshipped to the DDU. Witness Prescott answered "The DDU number for saturation is 0.1191." (Tr. 36/19573, l. 14.) Witness Prescott admitted that there is a difference between 25.7 cents and 11.91 cents.

Q. Okay. Well, so just to clarify, let me just make sure, you are not contending, are you, that the first number, 25.7 cents, is the same as 11.91 cents?

A. No, I [am] not.

Q. So this is in error?

A. Well, the statement is not very articulate.

Q. Well, isn't it just in error? Just wrong?

A. Well, yes. [Tr. 36, 19574, l. 22 through 36/19575, l. 4.]

Dr. Haldi correctly delineates unit piece costs for pound-rated mail between levels of sortation, and delineates unit pound costs between point of entry. This distinguishes between sortation and delivery costs (per piece) and transportation costs by point of entry. Witness Prescott would confuse the issue by stating, incorrectly, that Dr. Haldi does not delineate a distinction in pound-rated costs between point of entry.

**H. Witness Prescott's Criticism of the "Truing-Up" Methodology, Although Theoretically Sound, Is Empirically Insignificant**

Witness Prescott takes issue with Dr. Haldi's method of "truing-up" costs (and rates). Theoretically, witness Prescott makes an interesting point. However, as he has already observed regarding Table A-1, it is impossible to "true-up" to any sortation level rather than using a single number to adjust costs within letters and nonletters. This is because the Postal Service has not provided the information required to distinguish costs to the level necessary against which witness Prescott would have Dr. Haldi "true-up."

Again, witness Prescott attempts to obfuscate Dr. Haldi's work with a minor point having little significance. Witness Prescott is partially correct in theory; ideally one would like to be able to "true-up" costs to each sortation level. In reality, the Postal Service has not provided the Commission or intervenors with enough information to do so, as witness Prescott pointed out in his criticism of Dr. Haldi's unit cost development in Table A-1 and subsequent cost projections against CRA costs in Table A-2.

Unfortunately, the Commission and intervenors in this case must work with real, not theoretically ideal, information. Attempting to "true-up" costs to the various sortation

levels either in letters or nonletters would be, at this point, wasted effort and would be empirically insignificant.

**I. Witness Prescott Completely Misunderstands and Misconstrues Dr. Haldi's Use of Two Alternative Cases to Illustrate the Effect of Weight on Nonletter Piece Costs**

Witness Prescott does not appear to understand Dr. Haldi's use of two alternate cases to illustrate his point on the effect of weight on costs for nonletter mail. Dr. Haldi stresses the point that weight plays a role in cost. The Postal Service has neither developed nor presented adequate information regarding weight. Its studies, in particular Library Reference LR-H-182, fall significantly short of providing meaningful information. In fact, as Dr. Haldi points out, the results obtained through an analysis of LR-H-182 are "absurd." Thus, no one knows with any degree of certainty the degree to which weight affects cost. To demonstrate his point, Dr. Haldi presents two cases which demonstrate the extreme opposite effects of weight. In Case I, Dr. Haldi assumes 2.33 cents per piece is actually a weight-related cost. In Case II he assumes only one-fourth of that amount is weight-related cost (*i.e.*, very little costs are weight-related). Dr. Haldi does not assert that either case is true, but posits that the true weight-related cost for nonletters probably lies somewhere within the range he presents.

Witness Prescott says "Witness Haldi's analysis of the costs associated with weight as utilized in Table A-14 (or subsequent Tables) have no bearing on his ultimate rate design for pound-rate mail." (Tr. 36/19540, l. 17 through 36/19541, l. 1.) Next, under cross-examination, the question was asked "Witness Haldi assumes that 2.33 cents

per piece should be considered weight-related for all non-letters. Is that an accurate statement of what you believe Dr. Haldi does?" Witness Prescott responded "Yes." (Tr. 36/19569, ll. 11-14.)

Thus, although witness Prescott begins by complaining that Dr. Haldi's cost analysis in Table A-14 and subsequent tables has no bearing on his proposed rates, he then contends that they do. Continuing under cross-examination,

Q. So you think he is of the view that 2.33 cents per piece should be considered weight-related?

A. In purposes – for purposes of the calculations that he made in his appendices, yes. [Tr. 36/19569 ll. 15-18.]

Pressed further, witness Prescott continues with his contention that Dr Haldi uses 2.3 cents per piece in his rate design

Q. I would ask you, if you didn't get the drift of what Dr. Haldi was doing, saying that since no one knew what the weight cost relationship was, he would take two extreme cases and assume that it was somewhere in between, and that one of the cases was 2.33 cents per piece, that's case one, and case two was 0.5825 per piece and that was case two, and then he compared the two, and isn't that what he was doing with those two numbers rather than vouching for those numbers?

A. Well, when he went to his Appendix C to develop or finish his analysis, for example, table C-8 is based on the 2.33 cents per piece. There is no comparable table to C-8 on the 0.5825. **I would assume** [emphasis added] that he's giving more credibility to the 2.33, since he's using that in the later steps in his analysis.

Q. In your testimony, on the last line of this page, you say Witness Haldi's analysis of the costs associated with rate as utilized in Table A-14 or subsequent tables, have no bearing on the ultimate rate design for pound rate mail; correct?

A. They have no bearing on the rates that he shows in his table C-10. It has a bearing on the costs that he shows in his table C-9, his costs in his table C-8, those two tables.

Q But it has no bearing on his proposed rates; correct?

A. Yes. [Tr. 36/19570, l. 23 through 19571, l. 24.]

Witness Prescott finally returned to initial criticism, that Dr. Haldi did not use either Case I or Case II in developing his proposed nonletter rates.

So the questions remain. Is witness Prescott criticizing Dr. Haldi for not using either case? Or is he criticizing Dr. Haldi for not using the Case I weight allocation of 2.33 cents per piece? Or is he complaining that Dr. Haldi developed Case I with 2.33 cents per piece allocated to weight first and neglected Case II's allocation of 0.5825 cents per piece? At this point, one is not certain what witness Prescott is criticizing.

Dr. Haldi presented two cases for the Commission to examine. In developing his rate proposals, however, he favored neither. Instead, he accepted witness Moeller's requested 0.53 cent pound rate.

Witness Prescott's criticism of Dr. Haldi's development of two case studies to illustrate the weight-cost relationship, whatever that criticism may be, should be disregarded. It is irrelevant and misleading. Witness Prescott has shown difficulty in deciding exactly what his criticism is, and the Commission should discount whatever the criticism might be accordingly.

**J. The Number of Errors Witness Prescott Alleges in Dr. Haldi's Tables is Misleading in That Alleged Errors Are Said to be Errors Every Time the Numbers Ripple Through Subsequent Tables**

Witness Prescott takes the position that whenever he alleges an error — mathematical or otherwise — all subsequent tables are corrupted by that alleged error. This is misleading. Witness Prescott asserts that the three alleged “mathematical errors” discussed *supra* continue throughout Dr. Haldi’s analysis. However, as has been shown (and acknowledged by witness Prescott), the total impact would be no more than one-tenth of one cent on Dr Haldi’s proposed rates. (Tr. 36/19549, l. 14-6.)

As has been shown, the total impact of these “mathematical errors,” in reality, is even less. Witness Prescott attempts to construct a building with no foundation.

**K. Witness Prescott Continues to Mislead by Complaining That Dr. Haldi Does Not Use the Unit Costs Developed Beginning with Table A-14 (and Subsequent Tables) in His Ultimate Rate Design for Pound-Rated Mail, Then Claiming That Dr. Haldi Does**

Witness Prescott complains that “Witness Haldi’s analysis of the costs associated with weight as utilized in Table A-14 (or subsequent Tables) have no bearing on his ultimate rate design for pound-rate mail.” (Tr. 36/19540, l. 17 through 19541, l. 1.) Then, in his oral cross-examination, he contends that Dr. Haldi does rely on 2.33 cents per piece in his rate design:

Q Let me ask you to turn to page 8, where you discuss Table A-14, and there, beginning on line 14, you say Witness Haldi assumes that 2.33 cents per piece should be considered weight-related for all non-letters. Is that an accurate statement of what you believe Dr Haldi does?

A Yes.

Q So, you think he is of the view that 2.33 cents per piece should be considered weight-related.

A In purposes – for purposes of the calculations that he’s made in appendices, yes.

Q Okay. And what were the purposes of those calculations that he made in his appendices?

A Well, this gets into the inputs into the rate design versus the calculations that he’s made. When he developed his aggregate cost true-ups and his test of the distribution of the costs, he assumed a weight of 2.33 cents. In his actual rate design for non-letters, it never appears.

Q Absolutely. He did not use 2.33, correct? But rather --

A **But he has.** He uses that number in many of his tables, and because my exercise here in this appendix was to critique the issues and the problems with each of the tables, I needed to address the 2.33 cents. [Tr. 35/19569 l. 9 through 19570, l. 8, emphasis added.]

Finally, witness Prescott concedes that Tables A-14 or subsequent tables have no bearing on [Dr. Haldi’s] proposed rates (Tr. 36/19571, ll. 22-24). He was then asked: “Do you have a problem with Dr. Haldi’s analysis that we need to know more about the effect of weight on cost with respect to non-letters?” His reply was “I’ve not addressed that in my testimony.” (Tr. 36/1972, ll. 8-11.)

It is impossible to obtain ideal accuracy when the Postal Service does not provide the cost data required to develop alternate projections. That is the major point behind Dr. Haldi’s development of two alternate weight-related cost scenarios. Witness Prescott appears confused as to whether Dr. Haldi used Table A-14 or subsequent tables in the ultimate development of his nonletter rates. He appears to want to argue both ways — that Dr. Haldi did and did not. The truth is that Dr. Haldi did not.

The major thrust of witness Prescott's criticisms are aimed at Dr. Haldi's assumptions and interpolations, which are necessitated by the Postal Service's failure to provide more detailed cost information, directly or indirectly. If the Postal Service were to develop a reliable study of the weight/cost relationship for Standard A ECR mail, more accurate cost development would be possible, eliminating the need to present alternate cases highlighting possible weight-related costs.



**V. OTHER INTERVENOR TESTIMONY PROPOSES CHANGES TO THE POSTAL SERVICE REQUEST FOR STANDARD A ECR WHICH WOULD BE COUNTER-PRODUCTIVE AND SHOULD NOT BE RECOMMENDED**

Four intervenor witnesses (Clifton, Chown, Bradstreet, and Bentley) submitted direct testimony that would modify significantly the Postal Service's request for Standard A Mail. All of those intervenor witnesses' proposals should be rejected. Each is discussed below.

**A. Witness Clifton's Proposal To Increase Standard A Rates in Order to Reduce the Second and Third Ounce Rates of First-Class Workshared Mail Misapplies the Concept of Cross-Subsidy and Should Not Be Recommended**

**1. Witness Clifton Proposed Additional Increases to Standard A Commercial Rates**

Witness Clifton's testimony (ABA/NAA-T-1, Tr. 21/10815-89) proposed that the 2<sup>nd</sup> and 3<sup>rd</sup> ounce rates for First-Class workshared mail be reduced from 23 cents to 12 cents, and that the associated revenue loss be made up by increasing the Standard A cost coverage by 2.8 percent (the equivalent of 0.4 cents per piece for all Standard A Mail below the breakpoint). *Id.*, p. 2, Tr. 21/10820.

Witness Clifton concludes that the finding of no additional attributable cost increases associated with the 2<sup>nd</sup> and 3<sup>rd</sup> ounces of Standard A Mail must be wrong. However, he then relies on Exhibit USPS-44B as support for his view that increases in costs due to the 2<sup>nd</sup> and 3<sup>rd</sup> ounce of FCM workshared and Standard A are very small, citing his Technical Appendix A. *Id.*, p. 4, Tr. 21/10822. Witness Clifton states that, since Standard A and FCM workshared letter mail have very similar physical

characteristics, the processing and delivery costs of Standard A and FCM workshared letter mail must also be similar. *Id.*, p. 3, Tr. 21/10821.

Witness Clifton also argues that the Postal Service's (current and proposed) rate structure presents "severe equity issues," since Standard A mailers pay zero cents extra for the 2<sup>nd</sup> and 3<sup>rd</sup> ounce, while FCM workshared mailers pay 23 cents extra for the 2<sup>nd</sup> and 3<sup>rd</sup> ounce. Witness Clifton further alleges that the "lack of an incremental charge" for the 2<sup>nd</sup> and 3<sup>rd</sup> ounce of Standard A Mail creates an "apparent cross-subsidy issue for Standard A Mail." His proposed solution is to raise the cost coverage/unit contribution for Standard A commercial, and lower it for FCM workshared mail (although he never admits that he is reducing the FCM coverage).<sup>13</sup> *Id.*, pp. 5-6, Tr. 21/10823-24.

Witness Clifton proposes a 2.8 percent increase in Standard A commercial cost coverage (above the Postal Service's proposal), which would result in an additional \$109 million in revenue, 563 million fewer Standard A commercial mailpieces, and reduced volume variable costs of \$53 million. *Id.* pp. 15-16, Tr. 21/1044-45. He estimates the net result of his proposals would be an additional \$3 million in net postal revenue.

Witness Clifton states that he does not make any formal rate recommendation for Standard A Mail, but his proposal assumes a uniform increase among Standard A Regular and ECR products below the breakpoint. *Id.*, pp. 15-17, Tr. 21/10833-35.

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<sup>13</sup> While not hesitating to shift costs onto Standard A Mail, witness Clifton does not propose any specific rates for Standard A Mail in the body of his testimony, nor does he propose any change in the 3.3 ounce breakpoint about which he complains.

**2. On Cross-examination, Witness Clifton Admitted Weaknesses in His Proposal**

During cross-examination, witness Clifton observed that he had not examined parcel post (with a far lower cost coverage than Standard A Regular) in formulating his “apparent cross-subsidy” argument. Tr. 21/11027-28.

Witness Clifton also acknowledged that his proposed increase in Standard A coverage and reduction in First-Class coverage are not consistent with the value of service criterion in section 3622(b)(4). Tr. 21/11046, ll. 5-6. He admitted that First-Class Mail has a higher priority of delivery than Standard A Mail (Tr. 21/11034, ll. 21-22), that First-Class Mail receives forwarding without additional charge while Standard A Mail does not (Tr. 21/11035-36), and that First-Class Mail travels long distances by air while Standard A Mail generally does not (Tr. 21/11036, ll. 3-6).

**3. Witness Haldi’s Rebuttal Testimony Exposed Additional Weaknesses of Witness Clifton’s Analysis**

Dr. Haldi, in VP/CW-RT-1, identified several further weaknesses in witness Clifton’s analysis. One glaring weakness, which drew the attention of several intervenors, was witness Clifton’s unprecedented application of the economic principle of **cross-subsidy**. This was no minor detail, since the existence of any cross-subsidy between subclasses requires intervention of the Commission under the Postal Reorganization Act.

In written discovery on his testimony, witness Clifton was asked to explain why he believes that First-Class Mail is cross-subsidizing Standard A Mail, since Standard A

Mail revenues amply cover Standard A Mail attributable and incremental costs. Witness Clifton's explanation of his unconventional belief that First-Class Mail is cross-subsidizing Standard A Mail referenced (as his economic authority) a treatise by Carlton and Perloff which, according to witness Clifton, "defines cross-subsidization in a way that is more germane to these proceedings." Response to ADVO/ABA/NAA-T1-1, Tr. 21/10914-16.

Dr. Haldi researched witness Clifton's cited authority, not only obtaining and reviewing the treatise cited by witness Clifton, but also the articles cited by the treatise itself in the section relied upon by witness Clifton. The results were illuminating.

The example cited by witness Clifton does not expressly define cross-subsidy, but merely provides an example of price discrimination which the authors describe as "cross-subsidy". Furthermore, insofar as the cited Carlton and Perloff example implies a definition of cross-subsidy, one of the two articles cited by the treatise does not address cross-subsidy, and the other flatly contradicts witness Clifton's position. VP/CW-RT-1, pp. 25-28, Tr. 32/17307-10.

Witness Clifton is no stranger to postal rate setting, yet he has intentionally taken an economic concept — cross-subsidy — which has a clear, statutorily-significant meaning in postal ratesetting proceedings, and misapplied it to a relationship between two postal products without any factual or theoretical justification. He presumably selected the term cross-subsidy because it is almost unequaled in its pejorative connotations. Dr. Haldi's rebuttal testimony demonstrates this fundamental mistake in witness Clifton's argument.

Additionally, Dr. Haldi's testimony points out that under the Revenue Forgone Reform Act, witness Clifton's proposed increase in the mark-up on Standard A commercial would cause the mark-up on Standard A Nonprofit to increase in tandem (by one-half). VP/CW-RT-1, p. 18, Tr. 32/17300. Only after this omission was brought to witness Clifton's attention did he admit this impact. *See* witness Clifton's response to USPS/ABA/NAA-T1-15, Tr. 21/10971.

Dr. Haldi also refutes witness Clifton's assertion that a high implicit coverage is, *per se*, an indication of cross-subsidy to any other class of mail, as well as his assertion that any subclass of, or rate category within, Standard A Mail is currently being, or will be, subsidized under the Postal Service's requested rates. VP/CW-RT-1, p. 19, Tr. 32/17301. First, Dr. Haldi starts with a correct definition of cross-subsidy. Next, he shows how witness Clifton's attack on the rate averaging employed in Standard A Mail rate design also applies to current First-Class Mail rate design, which rate averages within ounce increments. *Id.*, p. 28, Tr. 32/17310.

Dr. Haldi demonstrates that witness Clifton's proposed reduction in cost coverage for First-Class Mail is neither properly analyzed nor adequately justified. *Id.*, p. 19, Tr. 32/17301. For example, witness Clifton does not show how his proposed reduction in First-Class Mail's cost coverage is justified in terms of any of the non-cost criteria of the Act. Additionally, witness Clifton does not show why implicit cost coverage relief is not available from other First-Class Mail rate categories. Nor does witness Clifton even attempt to show how witness O'Hara misapplied or misinterpreted the noncost criteria when setting cost coverages for Standard A Regular and ECR. *Id.*, p. 29, Tr. 32/17311.

Dr. Haldi also expressed concern that if the Commission recommended witness Clifton's proposal, it could balkanize the First-Class Mail rate categories. Inevitably, the Commission would be called upon to grant some kind of relief to the additional-ounce rate for other portions of the First-Class mailstream. If each such request is analyzed and presented separately, the foreseeable result could be separate rates for (i) the second and third ounces of workshared letter mail; (ii) the fourth through the eleventh ounces of workshared letter mail; (iii) the second and third ounces of single-piece letter mail; (iv) the fourth through the eleventh ounces of single-piece letter mail; (v) the extra-ounce rate for flats that weigh less than, say, 4 or 5 ounces; (vi) the extra-ounce rate for flats that weigh more than, say, 4 or 5 ounces; and (vii) the extra-ounce rate for residual, non-letter, non-flat pieces (*i.e.*, parcels). *Id.*, p. 24, Tr. 32/17306.

#### **4. Witness Crowder Also Probed Limitations and Revealed Defects in Witness Clifton's Testimony**

Witness Crowder's rebuttal testimony (ADVO-RT-1 Tr. 34/18301-66) also criticized witness Clifton's proposal.

Witness Crowder states that the cost data on the record demonstrate that the Standard A rate design is cost-based, and that second- and third-ounce Standard A mailpieces "far more than cover their costs." Therefore, witness Clifton's assertion of an apparent cross-subsidy is "simply wrong," and his definition of cross-subsidy "comports with no legitimate economic definition." *Id.*, pp. 15-16, Tr. 34/18318-19.

**5. Witness Andrew Demonstrates Further Errors in Witness Clifton's Testimony**

Witness Andrew also criticized witness Clifton's proposal in his rebuttal testimony (MOAA, *et al.*-RT-1, Tr. 36/19663-729). He notes that witness Clifton fails to substantiate his allegations of cross-subsidy with economic tests for cross-subsidy. *Id.*, p. 24, Tr. 36/19690. Witness Andrew then documents the absence of any cross-subsidy. *Id.*, pp. 40-43, Tr. 36/19706-9.

Witness Andrew also observed that changes in First-Class workshared unit costs can be attributed to shifts in mail mix (from nonautomation mail to automation mail), which cannot be expected to continue, and which the Postal Service recognized in its roll-forward factor. *Id.*, pp. 27-30, 32-34, Tr. 36/19693-96, 19698-700. He criticized witness Clifton's excessive reliance on 1994-96 CRA data, documenting that a review of 1988-96 CRA data show the results of the latter three years to be anomalous. *Id.*, pp. 31-32, Tr. 36/19697-98. He also discussed the fact that Standard A costs and rates are not germane to the development of First-Class costs and rates. *Id.*, pp. 35-39, Tr. 36/19701-05.

**6. Witness Clifton's Proposals Should Not Be Recommended by the Commission**

For the following reasons, witness Clifton's proposal to reduce the 2<sup>nd</sup> and 3<sup>rd</sup> ounce rates for First-Class workshared mail, and to increase the rates for Standard A Regular and ECR mail, should be rejected:

- The authorities relied on by Witness Clifton for his definition of cross-subsidy actually conflict with his use of the term;

- Witness Clifton fails to substantiate his allegations with documentation of economic tests for cross-subsidy;
- Witness Clifton never addressed the statutory noncost criteria to justify his proposed changes to the First-Class and Standard A cost coverages; in fact, witness Clifton admitted that First-Class workshared mail receives certain services and preferential treatment unavailable to Standard A Mail, and that First-Class workshared mail has a higher value of service. Witness Clifton does not adequately justify his refusal to seek relief for First-Class workshared rates from other First-Class rates, instead seeking to shift revenue requirement between classes. Witness Clifton fails to demonstrate that Standard A costs and rates are germane to the calculation of the First-Class revenue requirement;
- Witness Clifton never addresses the balkanizing effect which his proposal can be expected to have on First-Class rates; and
- Witness Clifton's testimony never addressed the impact of his proposal on Standard A Nonprofit rates (and lacked any analysis comparing Standard A Nonprofit rates and handling to that of First-Class workshared).

**B. Witness Chown's Proposed Alternative Methodology for Allocating Institutional Costs Either Adds a New Criterion to Section 3622(b) or Gives Excessive Weight to Her Private Definition of Fairness, and Should Be Rejected**

**1. Witness Chown Proposes an Alternative Methodology for Allocating Institutional Costs**

Witness Chown's testimony (NAA-T-1, Tr. 25/13261-92) proposes an alternative methodology for allocating institutional costs, which she characterizes as a refinement of a prior proposal made by her that was rejected by the Commission in Docket No. R90-1. (*Op. & Rec. Dec.*, Docket No. R90-1, pp. IV-11-17). She states that, currently, institutional costs are allocated to classes and subclasses based [solely] upon a mark-up or cost coverage over actual attributable (volume-variable) costs. These mark-ups or cost



coverages are calculated by applying the criteria of 39 U.S.C. section 3622(b) to the actual volume variable costs of the different classes and subclasses of mail. *Id.*, pp. 2-3, Tr. 25/13263-64. Her view of the process used to arrive at recommended markups and coverages seems remarkably simplistic.

Witness Chown identifies four functions which the Postal Service provides: mail processing, window service, delivery, and transportation. She states that mailers once had no choice but to purchase all four functions as a single package, while today mailers can purchase different mixes of these basic functions by selecting certain classes and subclasses of mail. Witness Chown expresses concern that the Commission may adjust downward the institutional contribution of ECR despite the fact that the attributable costs of ECR mail are substantially delivery costs — the source of a large share of the Postal Service's institutional costs. *Id.*, pp. 3-4, Tr. 25/13264-65.

For reasons no altogether clear, witness Chown is of the belief/asserts that the current methodology for allocating institutional costs is appropriate only where every class and subclass of mail utilizes the same mix of the four basic functions. Since individual classes and subclasses of mail utilize different mixes of these functions, Standard A ECR Mail can use a substantial portion of one function, such as delivery, where most of the Postal Service's costs are allocated, not attributed. Currently, Standard A ECR contribution to institutional costs is a function of two unrelated numbers: the total amount of costs attributed to Standard A ECR, and the cost coverage assigned to it. Witness Chown proposes that the Commission correct the problems she perceives in the current method of assigning institutional costs by altering or weighting

volume-variable cost so as to reflect the mix of functions used by the various classes of mail, and the proportion of each function utilized. *Id.*, pp. 4, 11, Tr. 25/13265, 13272.

Witness Chown's testimony divides the Postal Service's total attributable costs by class and subclass, each reflecting the four basic functions. She states that cost segments which she did not incorporate into her analysis are captured by the piggyback factors. She then identifies what percentage of the total allocated costs for First-Class letter mail and Standard A ECR was identified with each function. Witness Chown deems institutional costs not directly related to the four basic functions to be system-wide institutional costs. *Id.*, pp. 5-8, Tr. 25/13266-69.

Witness Chown describes her goal as enabling the Commission "to apply their judgment to a single cost figure for each subclass." She describes this methodology as "weighted attributable costs," whereby each dollar in attributable costs for a given function is weighted, or augmented, by a factor equal to the percentage of total institutional costs divided by the percentage of attributable costs for that function. *Id.*, pp. 13-14, Tr. 25/13274-75. Recognizing that volume-variable costs thus weighted and rearranged lack any economic significance whatsoever, they are to be used only as the basis for the allocation of institutional costs, after which they are to be discarded.

Witness Chown states that her testimony does not propose a specific assignment of institutional costs. Nevertheless, she calculates the weighting factors for the four main postal functions, and computes the weighted attributable costs for each class and subclass. She states that, under her methodology, if Standard A ECR were assigned the same target revenue that has been proposed by the Postal Service, its mark-up would be near the

systemwide average (rather than 50 percent above the system-wide average, as under the Postal Service's proposal). In other words, since such a high proportion of Standard A ECR's attributable costs is related to delivery, it would automatically be assigned a substantially higher amount of institutional costs under her approach than under the current methodology, which is her goal. *Id.*, pp. 17-18, Tr. 25/13278-79.

**2. On Cross-examination, Witness Chown Asserted that Her Opinion Was the Only Common-sense Standard of Fairness and Equity**

During cross-examination by counsel for Val-Pak/Carol Wright, witness Chown observed that the rates determined by the Commission in prior dockets were appropriate only when the recommended coverage factors comported with her personal interpretation of fairness and equity. Tr. 25/13414, ll. 6-11. In fact, she further explained that her definition of what rates were "appropriate" was neither legal nor economic, but "common-sense." Tr. 25/13415, l. 24 to 13416, l. 2. She also averred that her methodology was an improvement — a better method to ensure the appropriateness of institutional cost assignments — over the method used by the Commission in prior dockets. Tr. 25/13423, ll. 12-23, 13427, ll. 4-14, and 13433, ll. 10-18.

**3. Witness Haldi's Rebuttal Testimony Exposed Additional Weaknesses of Witness Chown's Methodology**

Dr. Haldi identified several weaknesses in witness Chown's methodology. VP/CW-RT-1, Tr. 32/17281-322. Examination of the impact of witness Chown's weighted attributable costs, assuming the Postal Service's requested mark-ups are

applied, results in an assignment of institutional costs to certain subclasses of mail dramatically different from those resulting from the current method. *See* Exhibit NAA-1A, p. 5, Tr. 25/13285 and Exhibit NAA-1D, Tr. 25/13289. Dr. Haldi asks: “what in witness Chown’s methodology has caused such altered outcomes”? He points out that either witness Chown’s methodology has implicitly added a new rate-making criterion,<sup>14</sup> or it has implicitly given extremely heavy and unprecedented weight to her particular interpretation of one of the existing statutory criteria.<sup>15</sup> *Id.*, pp. 7-8, Tr. 32/17289-90.

Dr. Haldi points out that, if witness Chown’s methodology adds a new non-cost criterion to section 3622(b), it must be rejected for violating the Act.<sup>16</sup> Likewise, her methodology may be an attempt to place unprecedented and undue emphasis on her interpretation of criterion 1 — even before the Commission begins its analysis and

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<sup>14</sup> Witness Chown does not explicitly formulate any such criterion, but it would embody her repeated desire to “reflect the benefit each class receives from [identifiable] institutional costs.” Tr. 25/13421, ll. 23-24. In fact, witness Chown explicitly denies that her methodology adds a new criterion to the Act. Tr. 25/13424, ll. 18-19.

<sup>15</sup> The Second Circuit rejected an earlier effort to identify a single dominant (non-cost) criterion that would “play a central role in postal ratemaking.” Direct Marketing Ass’n v. United States Postal Service, 778 F.2d 96 (2d Cir., 1985). The court repudiated the argument that Congress had identified a certain criterion as “the benchmark for the assignment of institutional costs. Rather, it is clear that no single factor was intended by Congress to be the ‘primary factor’ in making the assignments.” *Id.* at 103-04.

<sup>16</sup> “The Rate Commission is to assign remaining costs reasonably on the basis of the other eight factors set forth by section 3622(b).” National Ass’n of Greeting Card Publishers v. United States Postal Service, 462 U.S. 810 (1983).

application of the non-cost criteria of the Act.<sup>17</sup> If so, witness Chown's proposed approach undoubtedly is meant to exercise a prior influence on the Commission's judgments, in line with her personal view of what is fair and equitable. *Id.*, pp. 8-9, Tr. 32/17290-91.

Dr. Haldi also observes that, if the Commission were to rearrange attributable costs in a way that reflects, it would be difficult for the Commission to give reasonable consideration to other noncost criteria, such as criterion 6, degree of mailer preparation, which heavily favors not loading institutional costs on those mailers who enter highly prepared ECR mail. *See Op. & Rec. Dec.*, Docket No. R94-1, p. V-99. Witness Chown's proposed approach builds a large judgmental component of its own into the basis she would have the Commission use — namely, her weighted attributable costs. Should the Commission opt to use her rearranged attributable costs, it would be forced either to yield, at least partially, to her personal standards of fairness, or else it would have to revamp totally the manner in which it interprets and applies the non-cost factors of the Act. *Id.*, p. 9, Tr. 32/17291.

Dr. Haldi also observed that witness Chown's proposed methodology would reintroduce a middle tier of institutional costs by mechanistically linking her

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<sup>17</sup> Witness Chown appeared to offer the following explanatory statement as the essential motivation for her proposal: "I think it is unfair to ask people with high mail processing and transportation costs to contribute large amounts to the institutional costs of the delivery function." As Dr. Haldi observes, witness Chown appears to view "fairness" as though it could have no meaning or application other than the one she attributes to it — the identification of institutional costs with certain subclasses of mail. Tr. 25/13430, ll. 17-19.

“identifiable” institutional costs with each subclass of mail, to ensure that each subclass somehow bears responsibility for its “fair share” of her “identifiable” institutional costs, which in her view can be reasonably assigned by weighting the attributable costs of each subclass on the basis of her cost-of-service estimates. This method therefore resembles the three-tier methodology once imposed on the Commission by the U.S. Court of Appeals for the D.C. Circuit, but later rejected by the U.S. Supreme Court.<sup>18</sup> *Id.*, pp. 10-11, Tr. 32/17292-93.

Dr. Haldi also observes that witness Chown’s methodology would distribute \$2.8 billion in incremental costs indiscriminately among subclasses, rather than ensuring that the revenue requirement of each subclass of mail reflect those incremental costs which are specific to that subclass. Further, her methodology would change the current distribution of what she calls “system-wide institutional costs,” without any justification for that change. *Id.*, pp. 12-14, Tr. 32/17294-96. Finally, Dr. Haldi observes that witness Chown’s methodology appears to reduce the “profit,” or institutional contribution of mailpieces that use a full range of services from the Postal Service at the expense of mailpieces which use a limited number of such services. *Id.*, p. 16, Tr. 32/17298.

As previously mentioned, other rebuttal testimony containing valid critiques of the analysis of witness Chown was filed by witnesses Crowder (ADVO-RT-1) (Tr.

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<sup>18</sup> See National Ass’n of Greeting Card Publishers (“NAGCP”) v. United States Postal Service, 569 F.2d 570, 589 (D.C. Cir. 1976) (emphasis added), mandating the “three-tier” method. This methodology was disapproved by the U.S. Supreme Court in NAGCP v. United States Postal Service, 462 U.S. 810 (1983).

34/18301-66), Andrew (MOAA, *et al.*-RT-1) (Tr. 36/19663-729), Christensen (USPS-RT-7) (Tr. 34/18212-46), Panzar (USPS-RT-13) (Tr. 34/18442-64), and Taufique (USPS-RT-21) (Tr. 34/18509-25).

#### **4. Witness Chown's Proposed Institutional Cost Assignment Methodology Should Not Be Recommended by the Commission**

For the following reasons, witness Chown's methodology to assign institutional costs among subclasses should not be recommended by the Commission.

- Witness Chown's methodology assumes that only her interpretation of fairness and equity can be considered correct;
- Witness Chown's methodology has either implicitly added a new rate-making criterion, or it gives extremely heavy and unprecedented weight to her particular interpretation of one of the existing statutory criteria;
- Witness Chown's methodology would hamstring efforts by the Commission to give reasonable consideration to other noncost criteria;
- Witness Chown's methodology resembles the three-tier methodology imposed on the Commission by the U.S. Court of Appeals for the D.C. Circuit, and later rejected by the U.S. Supreme Court;
- Witness Chown's methodology would distribute incremental costs indiscriminately between subclasses; and
- Witness Chown's methodology appears to reduce the "profit" or institutional contribution of mailpieces that use a full range of services from the Postal Service at the expense of mailpieces which use a limited number of such services.

C. **Witness Bentley's Proposals To Reduce First-Class Rates Are Not Justified by the Evidence in this Docket and Should Not Be Recommended**

Witness Bentley (MMA-T-1) (Tr. 21/11151-95) seeks reductions in First-Class Mail rates, arguing that the Postal Service's requested rates would burden First-Class Mail with an excessive contribution to institutional costs. Witness Bentley states that the Commission has expressed concern in four recent dockets regarding the respective institutional cost contributions by First-Class Mail and Standard A Mail. MMA-T-1, p. 5, Tr. 21/11158. Unsurprisingly, when discussing the pending docket, witness Bentley did not contrast the requested cost coverage of First-Class Mail with that of Standard A ECR Mail (because the Postal Service requested a significantly higher cost coverage for Standard A ECR than for First-Class Mail). *See* response to VP-CW/MMA-T1-1, where witness Bentley, using the Commission's methodology, identifies mark-up indices of 119 for the First-Class letters subclass, and 201 for the Standard A ECR subclass. Response to VP-CW/MMA-T1-1(d)(i), Tr. 21/11265. Instead, witness Bentley uses the amalgam of the Standard A Regular and ECR subclasses which he calls Standard A commercial.

For example, witness Bentley compares the cost coverages for First-Class letter mail (166.00 percent) and Standard A commercial (158.44 percent), as well as the mark-up indices for First-Class letter mail (1.19) and Standard A commercial (1.06) embodied in the Postal Service's requested rates, then asserts that the mark-up indices of First-Class letter mail and Standard A commercial are **not** roughly equivalent. *Id.*, p. 6, Tr. 21/11160. He later admitted, however, the mark-up indices are the **closest** they have been since Docket No. R74-1. Response to VP-CW/MMA-T1-1(c), Tr. 21/11264.



Witness Bentley also ignores how the difference in mark-up and unit contribution between First-Class letter mail and Standard A commercial has decreased in this decade. Unit contributions between Standard A commercial and First-Class letters are also closer under the Postal Service's requested rates than in the approved rates in previous dockets: the unit contributions of First-Class Mail are **twice** as large as Standard A under the Postal Service's proposals in this docket, while they were **three times** as large in the rates implemented following Docket Nos. R90-1 and R94-1. Response to VP-CW/MMA-T1-3, Tr. 21/11269-73.

Witness Bentley proposed reducing the First-Class Mail mark-up index by leaving single-piece First-Class first-ounce rates unchanged, thus eliminating \$809 million of the Postal Service's proposed \$2.4 billion revenue requirement. Witness Bentley also proposes lower rates for First-Class automation mail, and for the second ounce of First-Class single-piece letter mail. *Id.*, pp. 11-20, Tr. 21/11166-75, response to AMMA/MMA-T1-1, Tr. 21/11199-202.

In his testimony, witness Bentley did not apply the non-cost criteria in determining the respective cost coverages of First-Class Mail and Standard A commercial. *See* response to VP-CW/MMA-T1-2(b), Tr. 21/11268. He asserted that his proposed decreases in First-Class rates would comply with these criteria. *Id.* However, consideration of these criteria lends considerable support to the position that First-Class Mail deserves a higher cost coverage than all Standard A Mail.

**Criterion 2:** the contrast between the service given First-Class Mail and that given Standard A commercial is profound. Not only are the Postal Service's official

service commitments for First-Class Mail and Standard A Mail at nearly opposite ends of the spectrum, but the available evidence also indicates that First-Class Mail meets its service commitments far more often than Standard A Mail. In addition, witness O'Hara noted in his testimony that Standard A Mail has a relatively low intrinsic value of service, *lacks access to the collection system, receives ground transportation, may receive deferred delivery, requires mailer preparation, coordination, and planning to accommodate delivery requests, and has a lower price elasticity than First-Class Mail.* USPS-T-30, pp. 34-35, Postal Service Request, Attachment G, Rule 54(n).

**Criterion 4:** the rate of increase is approximately 0.5 percent higher for Standard A commercial than for First-Class Mail letters under the Postal Service's proposal (*see* Exhibit USPS-30D).

**Criterion 5:** Standard A ECR is in a competitive market with substantial alternatives. (*See* USPS-T-36, p. 26, ll. 3-7; USPS-T-30, p. 35, ll. 14-19.)

**Criterion 6:** the degree of preparation by the mailer is higher for Standard A commercial (especially ECR) than for First-Class Mail letters, favoring a lower cost coverage for Standard A commercial.

On balance, it could be argued that the noncost differences between the two postal products are greater than is reflected in the Postal Service's requested rates, and that the rates should reflect an even greater cost coverage differential than those requested by the Postal Service.

To conclude, witness Bentley's proposals to reduce First-Class Mail rates based upon past expressions of concern by the Commission regarding the respective

institutional contribution of First-Class and Standard A Mail are not supported by the facts in this docket, and should not be recommended.

**D. Witness Bradstreet's Proposal to Increase the Standard A ECR Pound Rate Is Not Justified and Should Not Be Recommended**

**1. Witness Bradstreet Proposed Increases to the Standard A ECR Pound Rate**

Kenneth Bradstreet, vice president and general manager of Advertisers Postal Service, filed testimony on behalf of the Association of Alternate Postal Systems ("AAPS"), direct competitors of the Postal Service for ECR saturation mail (AAPS-T-1, Tr. 23/11977-12024). Witness Bradstreet proposes a significant (but undefined) increase in the pound rate. *Id.*, p. 47, Tr. 23/12023.

Witness Bradstreet accused the Postal Service of "manipulating rates in such a way as to lower rates for competitive mail and increase rates for mail that has no competitive options." *Id.*, pp. 5, 15, Tr. 23/11981, 23/11991. He provided an analysis contrasting First-Class, Standard A Regular, and Standard A ECR rate increases since 1978, and concluded that the Postal Service's rate design and classifications have the purpose of harming its competitors. *Id.*, pp. 10, 16, Tr. 23/11986 and 11992. Witness Bradstreet also criticizes the Postal Service's Standard A weight/cost study (USPS-44B/LR-H-182) as a rigged study, which focuses on activities that are piece-driven rather than weight-driven, and on activities which are low-cost, and bypassed by ECR mailpieces. *Id.*, p. 35, Tr. 23/12011.

**2. Cross-examination Exposed Weaknesses in Witness Bradstreet's Testimony**

In response to discovery, witness Bradstreet stated that the Commission should accept his analysis that the Postal Service's cost computations are not trustworthy, even though his opinion lacks technical expertise. Response to VP-CW/AAPS-T1-1, Tr. 23/12059. He acknowledges that he did not argue that Standard A Regular and ECR rates should be increased based solely on the competitive concerns he expressed. Response to MOAA/AAPS-T1-7, Tr. 23/12035.

**3. Rebuttal Testimony Exposed Additional Weaknesses in Witness Bradstreet's Testimony**

Witness Buckel criticized witness Bradstreet's analysis of rate increases since 1978, noting that the rates set in Docket No. R77-1 were artificially high, driving two-thirds of Postal Service's pre-1978 saturation mail market share to postal competitors. Witness Buckel also showed that witness Bradstreet's criticisms of the weight/cost study did not reflect actual postal practices. He noted AAPS witness Green's admission that postal competitors' rates weight do not vary with weight ("we haven't been concerned with weight for so long since we're in the hand delivery") apparently contradicts witness Bradstreet's arguments for a higher Standard A ECR pound rate. SMC-RT-1, pp. 2-6, Tr. 32/17241-45.

Witness Andrew points out that witness Bradstreet fails to quantify, evaluate or analyze the alleged harm which AAPS members have suffered from Standard A ECR rates, and also provides no information as to how the proposed rates would harm postal

competitors. Witness Andrew also observes that witness Bradstreet fails to reflect the cost trends and worksharing cost savings since 1978 — or the fact that Saturation mail did not exist in 1978 — in his analysis of rate increases. MOAA, *et al.*-T-1, pp. 46, 48, 52, Tr. 36/19712, 19714, and 19718.

Witness Crowder also demonstrates that witness Bradstreet's assumptions regarding the relationship between weight and delivery costs are incorrect, and not worthy of reliance. ADVO-T-1, pp. 17-23, Tr. 34/18325-31.

For all these reasons, witness Bradstreet's proposal that the Commission recommend a significant increase in the pound rate should be rejected.

**CONCLUSION**

Val-Pak/Carol Wright submit that the record and testimony filed herein by Dr. Haldi support their rate and classification proposals, that the concept of the bottom-up development of Standard A ECR costs should be adopted, and that the Postal Service's request with respect to Standard A ECR mail should be modified as set forth in Dr. Haldi's direct testimony.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "William J. Olson", written over a horizontal line.

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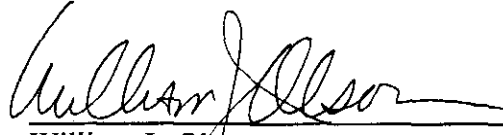
Val-Pak Direct Marketing Systems, Inc.,

Val-Pak Dealers' Association, Inc., and

Carol Wright Promotions, Inc.

# **CERTIFICATE OF SERVICE**

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with Section 12 of the Rules of Practice.

  
William J. Olson

April 1, 1998